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REA PROPOSALS FOR RURAL TELEPHONE SYSTEMS: IS REA HANGING UP THE LINE?

MF-136 ORIGINAL

HEARING

BEFORE A

SUBCOMMITTEE OF THE
COMMITTEE ON
GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

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REA PROPOSALS FOR RURAL TELEPHONE SYSTEMS: IS REA HANGING UP THE LINE?

THURSDAY, APRIL 18, 1985

House of Representatives,
Government Information, Justice,
and Agriculture Subcommittee
of the Committee on Government Operations,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:45 a.m., in room 2247, Rayburn House Office Building, Hon. Glenn English (chairman of the subcommittee) presiding.

Present: Representatives Glenn English, Robert E. Wise, Jr., John M. Spratt, Jr., Thomas N. Kindness, and Jim Lightfoot.

Also present: Leo Jardot, counsel; Sandra Hays, secretary; and Elaine Klionsky, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN ENGLISH

Mr. English. The subcommittee will come to order.

This hearing has been called to explore two proposals by the Rural Electrification Administration which could have a major impact on the rural telephone system. One proposal would eliminate the REA division, which sets technical and engineering standards for construction of telephone facilities.

Another proposal would require telephone companies or cooperatives borrowing from the REA to use working capital to supplement loan funds as a condition for the loan approval. Critics have charged that these proposals would increase the construction costs by as much as $130 million dollars a year, and unduly restrict the management flexibility of REA borrowers.

In 1949 the mission of the REA was expanded to include telephone service when Congress declared a national policy of assuring the availability of adequate telephone service to the widest practical number of rural users.

This goal also corresponds with congressional policy of universal telephone service expressed in the Communications Act of 1934. Undoubtedly, the REA program has been one of the greatest success stories of our Government and its citizens working together.

In my own State of Oklahoma only 32 percent of the farms had telephones when the program began in 1949. Today, more than 95 percent of the State's farms, as well as many rural homes and businesses, have telephones.

Some are arguing that REA's job is done. The question is, is the job done? Apparently the administration thinks so and that is the basis for proposing to end the REA program. However, according to REA, the number of households served by REA electric and telephone borrowers has increased each year.

Early growth of the program was mainly due to service being extended to households that had never before had electricity or telephones. More recently the growth has been primarily because of the rapid population increases that have occurred in rural America, particularly in the Sun Belt and Western States.

The issues before us today are not these broad policy questions. But rather, specific management proposals that the REA is considering. I applaud Government agencies that review programs in an effort to cut costs and increase efficiency. Too often, however, Government agencies get the cart before the horse. They decide to do something and then find out later what the impact is. Today we are seeking to find out if REA has the cart before the horse. What is the basis for these management proposals? What is the likely impact on the telephone companies and cooperatives that borrow from the REA? What is the impact on millions of people in rural America who rely on REA programs for telephone and electric service?

Frankly, I'm concerned that these proposals could result in lower quality service and higher cost to rural users. These questions deserve careful and full review before any action is taken.

Mr. Kindness.

Mr. KINDNESS. Thank you, Mr. Chairman. I apologize for being tardy this morning. The season is upon us. School groups are descending upon Washington and we all understand what happens when that occurs. You're late.

I'm very pleased that we're here this morning to examine some questions about the proposed elimination of the REA's standard setting function and the revision of the REA's general funds policy affecting loans from REA.

I think the proposals certainly ought to be examined closely. We're happy to have the opportunity to hear the testimony here this morning from those who look at it from both or perhaps all sides.

REA standardization may be a very necessary function. But perhaps it should not be provided without charge. Perhaps the answer really lies somewhere between the two extremes of argumentation.

If indeed it is as valuable a tool and as valuable a provision of service as has been indicated by some, very possibly it is valuable enough that it be the subject of a user fee. It has been described as being quite valuable. I'm not convinced that everything would fall apart if that function were not performed within the REA. It might be performed elsewhere. And perhaps the testimony will indicate that this morning.

But at any rate, it is the type of function to which there is a great deal of support. And perhaps that support could be converted into financial support.

As to the question of the moderation or change in the general funds policy, I certainly look forward to the illumination of that subject by our witnesses this morning. I'd like to understand better the ramifications of the general funds policy and exactly how it affects not only the functioning of rural telephone and electric organizations but also how it affects the taxpayer in terms of the flow of loan funds.

So, Mr. Chairman, I congratulate you upon your alertness to these topics and the work of the staff to bringing us to this point of illumination. I look forward to our testimony today to further understand these subject areas.

Mr. ENGLISH. Thank you very much, Mr. Kindness.

Mr. Spratt.

Mr. SPRATT. I have no comments to make. Thank you for calling these hearings however, Mr. Chairman.

Mr. ENGLISH. Thank you. Mr. Lightfoot.

Mr. LIGHTFOOT. I'd only add, Mr. Chairman, that again I think it's good that we're having the hearing today. And being from one of the more rural districts in the country we depend very highly on REA for both telephone and electric service. The service has to continue. And we're here to learn and that's what we hope to do.

Also, Mr. Chairman, Jim Courter made a statement for the record. And if you would, we'd like to have you enter that please.

Mr. ENGLISH. Without objection, statements from Representatives John R. Miller and James A. Courter will be made a part of the record.

[The opening statement of Mr. Miller, and prepared statement of Mr. Courter, follow:]

OPENING STATEMENT

THE HONORABLE JOHN MILLER

Mr. Chairman, I want to thank you for calling this hearing today to explore two proposals made by the Rural Electrification Administration (REA) to: eliminate REA's responsibility for setting technical and engineering standards for the construction of telephone and electrical facilities, and redefine what constitutes the "general funds" of an REA borrower in order to determine eligibility for REA financing.

These proposals should be carefully examined to determine their effect on rural telephone systems and users as well as their budgetary impact. I look forward to hearing the testimony of our witnesses and participating in the discussion of these important issues.

"A statement by the Honorable James A. Courter on the REA proposals for rural telephone systems."

April 18, 1985

Hearing of the Subcommittee on Government Information, Justice and Agriculture

The fifty year history of the Rural Electrification Administration (REA)has been marked by dramatic strides in providing telephone and electrical service to nearly all of rural America. As current budgetary constraints make it imperative that Congress exercise fiscal discipline, there is a need to examine all possible areas where savings can be realized.

Given the above situation, I respectfully ask that this Subcommittee consider the possibility of having the private sector accept the responsibility for researching and establishing the engineering standards with which rural telephone cooperatives would comply. Bell Communications Research (Belcore) already does much of the highly technical and innovative standard setting work for seven regional Bell operating companies. While REA and Bell standards are not identical, it is my understanding that there is a reasonable amount of technical similarity between the two. Thus, Belcore's adoption of this work, presently done by government laboratories, would represent a logical extension of the work already done to support Bell companies.

Having the private sector accept this research work as opposed to the REA continuing to do so would result in a roughly $400,000 reduction in the budget deficit. This would represent a small but significant inroad toward greater fiscal stability for our country as a whole and will hopefully be part of a comprehensive deficit reduction program.

I thank you, Mr. Chairman, for accepting my remarks into the records of this hearing.

Sincerely,

Jim Courter

JIM COURTER
Member of Congress

JAC/pfs

Mr. English. Mr. Wise?

Mr. Wise. No comments, Mr. Chairman. I appreciate the chance to be here.

Mr. English. Thank you very much.

The first witness this morning will be Mr. Harold Hunter, who is the Administrator of the Rural Electrification Administration at the Department of Agriculture.

Harold, if you will come forward, I believe you're going to be accompanied by Jack Van Mark who is the Deputy Administrator of REA, and Mr. John Arnesen who is the Assistant Administrator for Telephones with the REA.

I'd like to say right off that Mr. Hunter is a fellow Oklahoman and I certainly want to welcome him to this hearing.

Harold, before you begin your testimony, I would like to discuss a little matter that has caused great concern for me. On March 26, I sent you a letter requesting information about the proposals that are the subject of the hearing. I requested existing information, not new material, and asked that you provide it within a week. It became apparent after staff conversations that the information was not going to be provided in a timely manner.

We asked the General Accounting Office to assist us in obtaining that information. Two days after the GAO contacted you on my behalf, you sent me some of the information that I requested.

You also stated that there were no responsive materials to half the items that we requested. One of those items that we requested was item No. 4 containing legal items, memorandums, notes, and so on. I understand some of that finally showed up last night.

In response to item No. 3, requesting an economic and policy analysis, you sent us a document labeled Current Bulletin. This was the REA's Bulletin 300-5, which set the REA policy on general funds for REA borrowers. The problem was that this document was dated February 12, 1962.

Maybe that explains some of the confusion REA borrowers are having since they seem to recall that there was a new policy bulletin issued in 1969. In fact, we have a copy of the 1969 bulletin here. If you all need a copy for your records, we'd be happy to give you a copy.

But it makes us wonder, Harold, whether the REA is having some problems down there, whether they've got chaos within the organization, or whether this is an attempt by REA to thumb its nose at the Congress of the United States.

As a result of all this, I've got to say that privately I've had some folks urge me to put you under oath. But I told them, I've known Harold Hunter for several years. And I think that Harold Hunter will tell us the truth. I don't think he'll come before this committee and tell us any falsehoods at all.

So I'm not going to do that, Harold. I'm going to count on you for shooting straight with us and telling us how it is. I'd like to think I'm a reasonable person. But your lack of compliance with this request is certainly testing our patience. I'm going to give you another chance on it though. At the conclusion of the hearing I'd like you to reread the request for the information and to work harder at trying to comply with it. If necessary, we can ask the GAO to help you with it again. But please assist us with providing all the information that we requested in that letter.

And with that, we'll let you start.

STATEMENT OF HAROLD HUNTER, ADMINISTRATOR, RURAL ELECTRIFICATION ADMINISTRATION, DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY JACK VAN MARK, DEPUTY ADMINISTRATOR, AND JOHN H. ARNESEN, ASSISTANT ADMINISTRATOR FOR TELEPHONES

Mr. HUNTER. Chairman English, let me respond to that in just a quick and general way. As you would understand very well, there is a multitude of pamphlets of various types of material that has some degree of relationship. Yet we didn't feel it was particularly pertinent to the desires of this committee.

We had no intention to offend the committee. We recognize the importance of a good relationship with every committee and every Congressman that is interested in what is going on within our agency. And we will work closely with you and with your staff to try to make sure that we provide anything that is pertinent that has not been provided already. So we do offer our apologies in that regard. And we'll try to respond.

Mr. ENGLISH. One of the things that alarmed me a little bit was not the fact that you didn't provide some information, you sent us bulletins dated like 1962 when we knew there was one in 1969.

That kind of made us wonder what's going on here, whether you were having problems over there in the agency and you just didn't try to get it together, or what was taking place. It didn't make much sense to us.

Mr. HUNTER. Mr. Chairman, I would expect—I really don't know—but I would expect that probably the 1962 pamphlet also has pertinence to what we are considering here today.

And the failure to provide the 1969 material must have been an oversight. Because I don't even know the content of that particular—again, we will pursue it more precisely.

Mr. ENGLISH. I appreciate it.

Mr. HUNTER. Mr. Chairman and members of the committee, it is a pleasure to appear before you today to discuss some things that we are currently doing at REA.

I have a short statement. I would be happy to answer then any questions that you may have or any member of the committee.

As we are all aware, REA is celebrating it's 50th anniversary this year. It has been truly a remarkable program. Its loan guarantee programs have provided around $60 billion to rural electric and rural telephone utilities.

Virtually everyone in rural areas has reliable electric and telephone services. In some cases at lower cost than their city neighbors.

Collectively, REA electric borrowers serve 11 percent of the people in this country. REA telephone borrowers, 5 percent.

During 1983, electric borrowers revenues totaled $15.7 billion, $6 billion or 62 percent more than in 1980. More significantly, their net margins totaled $914 million, an increase of $517 million, or 130 percent more than the 1980 level.

In 1980, there were 67 electric borrowers with a deficit net margin. By 1983, that figure was down to 26. The downward trends in equity levels for electric borrowers had been reversed. Adjusting for inflation, the price for kilowatt hour of electricity on REA financed systems is still less than it was 20 years ago.

Telephone borrowers revenues totaled $2.8 billion in 1983, an increase of $1 billion or 57 percent over the year 1980. Their net income or margins were almost $400 million, an increase of more than 75 percent from 1980.

As in the electric program, borrowers' financial ratios have shown improvement over the past 4 years. Over 85 percent of the subscribers on REA financed telephone systems have private line, one-party service.

I mention these things to point out that not only has the program succeeded in bringing quality electric and telephone service to rural America, but also that the borrowers themselves are by and large strong financially, with strong management, and are well accepted by other sectors of the utility industry and in the private investment community.

The program achievements are a monument to those in Congress, both past and present, who conceived it and nurtured it, to the people who served in REA during the past 50 years, and most especially to the efforts of the people in rural America who participated in this self-help program.

In your communications to us you indicated you wanted to discuss our general funds policy in the telephone program and the telephone engineering standards function currently provided by REA. In the past, REA's policy has been to require telephone borrowers with excess general funds to use those funds to supplement and thereby conserve loan funds.

The changing telecommunications marketplace and a lessening of demand for REA loans indicate that a modification of this policy is appropriate.

While this administration is certainly in favor of allowing borrowers to be competitive in the telecommunications industry, that desire must be balanced against the need to insure that investments and expenditures of general funds do not impair the Government's loan security.

With this in mind we have on a case-by-case basis been allowing borrowers to exclude from general funds calculations all or parts of amounts invested in telecommunications projects when the amount requested does not exceed dividends and other distributions allowable without REA consent.

In other words, if a borrower meets the requirements to pay a dividend, the funds could alternatively be invested in telecommunications. We view this approach as a prudent compromise between the desire to foster the competition on the one hand, and the concern for loan security on the other.

It has resulted in the financially stronger borrowers taking the first steps to provide modern telecommunications services in rural areas while resulting in neither an additional demand for REA loan funds nor a lessening of borrower equity.

In regards to the review of the engineering standards function of REA, what has been proposed is just that. A review. What we have proposed and what is currently being done is a careful evaluation of whether a need still exists for Government involvement in the electric and telephone engineering standards function.

In the early years of the electric and telephone programs there was a lack of engineering expertise available to the borrowers. This expertise was provided by REA. As with so many Government functions however, the need for Federal involvement has lessened. But the service continues.

We are going to decide whether to retain, to modify, or to eliminate this service. We are weighing carefully the impact of any changes in our present standards setting procedures.

Mr. Chairman and members of the committee, that's the end of my prepared remarks. I will be happy to try to answer any questions which you might have.

[The prepared statement of Mr. Hunter follows:]

STATEMENT OF HAROLD V. HUNTER, ADMINISTRATOR,
RURAL ELECTRIFICATION ADMINISTRATION
BEFORE THE HOUSE SUBCOMMITTEE ON GOVERNMENT OPERATIONS
FOR GOVERNMENT INFORMATION, JUSTICE, AND AGRICULTURE
April 18, 1985

Mr. Chairman and members of the Committee, it is a pleasure to appear before you today to discuss some things that we are currently doing at REA. I have a short statement and then would be happy to answer any questions you may have.

As we are all aware, REA is celebrating it's 50th anniversary this year. It has been a truly remarkable program. Its loan and loan guarantee programs have provided around $60 billion to rural electric and telephone utilities. Virtually everyone in rural areas has reliable electric and telephone services, in some cases at lower cost than their city neighbors. Collectively, REA electric borrowers serve 11 percent of the people in this country; REA telephone borrowers 5 percent.

During 1983, electric borrowers' revenues totalled $15.7 billion, $6.0 billion, or 62 percent more than in 1980. More significantly, their net margins totalled $914 million, an increase of $517 million, or 130 percent more than the 1980 level. In 1980, there were 67 electric borrowers with deficit net margins. By 1983, that figure was down to 26. The downward trends in equity levels for electric borrowers have been reversed. Adjusting for inflation, the price per kilowatthour of electricity on REA-financed systems is still less than it was 20 years ago.

Telephone borrowers' revenues totalled $2.8 billion in 1983, an increase of $1.0 billion, or 57 percent over 1980. Their net income or margins were almost $400 million, an increase of more than 75 percent from 1980. As in the electric program, borrowers financial ratios have shown improvement over the past four years. Over 85 percent of the subscribers on REA-financed telephone systems have private-line, one-party service.

I mention these things to point out to you that not only has the program succeeded in bringing quality electric and telephone service to rural America, but also that the borrowers themselves are, by and large, strong financially, with sound management, and are well accepted by other sectors of the utility industry and in the private investment community.

The program achievements are a monument to those in Congress, both past and present, who conceived it and nurtured it, to the people who served in REA during the past 50 years, and most especially, to the efforts of the people in rural America who participated in this self-help program.

In your communications to us, you indicated you wanted to discuss our general funds policy in the telephone program and the telephone engineering standards function currently provided by REA.

In the past, REA's policy has been to require telephone borrowers with excess general funds to use those funds to supplement and thereby conserve loan funds. The changing telecommunications marketplace and a lessening of demand for REA loans indicate that a modification of this policy is appropriate. While this Administration is certainly in favor of allowing borrowers to be competitive in the telecommunications industry, that desire must be balanced against the need to ensure that investments and expenditures of general funds do not impair the government's loan security.

With this in mind, we have, on a case by case basis, been allowing borrowers to exclude from general funds calculations, all or parts of amounts invested in telecommunications projects when the amount requested does not exceed dividends and other distributions allowable without REA consent. In other words, if a borrower meets the requirements to pay a dividend, the funds could alternatively be invested in telecommunications.

We view this approach as a prudent compromise between the desire to foster competition on the one hand and the concern for loan security on the other. It has resulted in the financially stronger borrowers taking the first steps to provide modern telecommunications services in rural areas while resulting in neither an additional demand for REA loan funds nor a lessening of borrower equity.

In regards to the review of the engineering standards function of REA, what has been proposed is just that, a review.What we have proposed, and what is currently being done, is a careful evaluation of whether a need still exists for government involvement in the electric and telephone engineering standards functions. In the early years of the electric and telephone programs, there was a lack of engineering expertise available to borrowers. This expertise was provided by REA. As with so many government functions, however, the need for Federal involvement has lessened, but the service continues. We are going to decide whether to retain, modify or eliminate this service. We are weighing carefully the impact of any changes in our present standards-setting procedures.

That is the end of my prepared remarks. I will be happy to answer any questions you might have.

Mr. **English**. Harold, you provided the subcommittee with a copy of the extensive study on engineering standards, prepared for you by the REA task force. I noticed that it is dated March 6, 1985. I also noticed the study had "draft" stamped on it.

In fact, "draft" was stamped on just about every page. I'm just kind of curious. When did the study receive that stamp of draft on it? It seemed like a little of that ink was still wet when we got it.

[The draft study is printed in app. 2.]

Mr. **Hunter**. Well, not quite that wet I hope. But it was after a review that I'd looked at the study and felt that there was a need for more information; a need to look further into what options might be available that we ought to take into serious consideration.

Mr. **English**. On what date did you complete the review and decide to stamp it "draft"?

Mr. **Hunter**. Mr. Chairman, I don't have it in my mind. But I'd be glad to provide it to you.

Mr. **English**. We also have a letter from Mr. Van Mark, which went out to the—in fact I should say it's a memo—that went out to the project team members. It says, Additional Guidance to Project Team Reviews of REA Engineering Standards Setting Functions. It's dated April 8, which was 4 days after we requested that the information be supplied.

The question occurred in my mind as to whether or not this little memo here and the "draft" designation all arrived shortly after our letter requesting the information arrived. Was there any connection to that?

Mr. **Hunter**. In response to that sir, I will assure you that after having looked at the material provided to us by the task force, that I had the strong feeling that the review needed to be made wider in scope, that it ought to look further into the options or alternatives that might be available. And that there was a need to go farther.

Mr. **English**. You asked the task force to study whether there was a need for standards setting, and if there is a need, whether it should be done in the public or private sector. Did you consider studying the impact of eliminating the REA standards on the people who live and work in rural areas all over the country?

Mr. **Hunter**. Well, to eliminate it perhaps is an option which might be pursued by REA. One of the problems that we see is that any time that a function is provided within the Government and provided free of charge, in essence it discourages anyone competing with that, anybody providing a service from somewhere else.

There is the question, should there be just an abrupt elimination. I feel that in general our thinking at this time is that that would not be a wise approach. It would not be healthy, either for the industry, nor for the people that the industry serves.

In the same breath, the question of whether or not our program ought to be modified, whether or not it can be provided somewhere else, whether or not there can be another source of that type of a service identified in the private sector, is what we feel should be pursued.

Mr. **English**. Well, I guess that's what troubles me a little bit. Are you telling me that there is no question that if these standards are eliminated there is going to be a serious, detrimental impact on the people who live and work in rural areas of this country, unless there is someone else to pick it up who can do the same job and carry out the same function?

Mr. HUNTER. That assumption has to be considered. I think, though, as we consider that, we have to recognize that some 90 percent of the telecommunications industry falls outside of the area of REA financed industry.

And that part of the industry is not served by standard setting by the Government. This standard setting sometimes done inhouse, sometimes by entities that exist in the private sector for the purposes of setting standards. And that those standards are then accepted and used by those other providers of a telephone service which falls outside of the REA financed service.

The question of whether or not our borrowers will adapt and whether or not that will be appropriate as a solution is still open to conjecture.

Mr. ENGLISH. If the standard is done away with, is there a question in your mind that it is going to be harmful to people who live and work in rural areas? Or is it not going to be harmful to people who live and work in rural areas?

Mr. HUNTER. I feel that there have to be standards. If I build a barn out on my farm, there have to be standards. There has to be a plan. To go out and build a barn without some thinking direction for the concept, the shape of that barn, would be foolhardy.

So I am convinced there have to be standards to deal with. To what degree those standards are mandatory, to what degree those standards are absolutely alike in every case, is questionable in my mind. Because the barn that I might build on my farm may have the same requirements as a barn in some other area in this Nation.

And I think this same thing happens to some degree in the area of telecommunications. I think the fact that there is not a uniform, mandatory, binding Government-provided-standards-setting system for 90 percent of the industry, tells me that at least we ought to review the need for it in this other 10 percent. And that's all we're proposing here. That's all we've been doing.

Since about August of last year we have had this in our minds, we've been talking about it and allowing everybody to respond to it. And this is where we stand at the present time.

Mr. ENGLISH. Going back to your barn example. It's not a question of comparing the barn that you build on your farm with the barn that your neighbor builds, or some guy in an adjoining state builds.

It's more like we've got a large number of people, 50, 60, 70 people who all show up with their hammers and saws and they're all going to build that barn. Unless they're all looking at the same set of plans, they're going to have one big mess on their hands by the end of the day, aren't they?

Mr. HUNTER. Precisely. And that's why I say I need a standard. I need a plan when I build that barn. So certainly, I agree with that.

Mr. ENGLISH. So we're in complete agreement that there has to be the same set of standards or we're going to have a mess.

Mr. HUNTER. And that is being accomplished somehow in 90 percent of the telecommunications industry in this Nation. Because over 90 percent of it is outside of the requirements of REA standards.

Mr. **English**. Of course the situation in urban areas is different for telephone companies than in rural areas. Isn't it?

Mr. **Hunter**. They are somewhat different. But getting more and more similar as time goes by. Most systems, whether they be in the private sector or whether they be REA financed systems, most of those types of systems serve both rural and suburban and urban areas.

So the types of equipment and the types of standards, the requirements needed in order to make that service appropriate for their service area are getting more and more alike and are very similar in many cases.

Mr. **English**. I just noticed the conclusion in the executive summary of your study, the study of the REA task force. The conclusion says that the benefits of engineering standards to REA in accomplishing the present program objectives and policies overwhelmingly outweighs nonbenefits. A need for engineering standards setting exists in the rural electric and telecommunications program.

So we really don't have any disagreement about the need for the standards. Now the question is, If REA doesn't do it, who is?

You mentioned competition. I'm one of those who certainly believes if we've got people in the private industry that have the capability and the desire to go out and do one of these functions, I think they ought to do it.

Do you have somebody who has raised their hand, volunteered, and stepped forward and said we would sure like to carry out this function and apply these standards throughout the industry? We believe that we've got the authority to step out there and make sure that everybody complies so that we don't end up with one of those barns that looks kind of funny by the end of the day going in all which directions and never really fits together?

Mr. **Hunter**. There's something in the point you're making. I have one of those barns that looks a little bit like you're saying. It really didn't turn out just like I wanted it to turn out.

On the other side of the coin, let's consider the fact that in the industry, the vast amount of services rendered across this Nation is done without REA funding. It's done without REA standards. It's done with an approach which is different.

As far as someone jumping up and holding up their hands and saying we're ready right now to provide this service, that does not exist today, nor do I think it will exist as long as REA is openly in the business and indicating every intention to stay.

That doesn't mean that someone is out there. And we believe there is someone out there.

Mr. **English**. Well, you haven't had any volunteers and nobody has indicated that they're interested. But you think that if we put enough pressure on, if we dump this standard setting function out there, maybe we can force somebody to do it.

Mr. **Hunter**. Well, I'd like to put that in reverse and say that as long as REA continues to hold that market in their hands, it's not going to be very tempting to anyone else to get out and make a contribution to progress.

Mr. ENGLISH. I see. So we're going to force something to happen. Maybe it will, maybe it won't. We're just going to push it out there, keep our fingers crossed, close our eyes and hope it happens.

Mr. HUNTER. Mr. Chairman, I feel that would be entirely too presumptive on our part. But I think that does point up the necessity for something that you mentioned in your opening remarks that I think is very appropriate.

And that is that this issue deserves and needs more study.

Mr. ENGLISH. I think we're all in agreement on that. Before we do anything it sure needs more study.

Let me follow up very quickly. I've got other members here and I'm taking too much time. I realize that. How many folks in rural areas, how much of the rural areas are serviced by non-REA borrowers?

Mr. HUNTER. I don't have an answer for that. Mr. Arnesen, do you have anything that would touch on that?

Mr. ARNESEN. No. We do not have any specific information on that. But obviously all of the large companies do serve rural areas. The Bell Co. serves rural exchanges. General Telephone Co. serves rural exchanges. United Telephone Co. serves rural exchanges.

So there are a lot of rural communities that are served by the larger telephone companies.

Mr. ENGLISH. If I remember correctly, the difference is that the REA is assisting those companies that are servicing areas that AT&T didn't want. Isn't that correct?

Mr. HUNTER. That is very true. But times have changed and some of these areas are more urban now.

But I think you make a tremendously good point. The justification for the program being set up to begin with was very real. I think the need for standards at that time was very real because we lived in a different era of capability and expertise.

Mr. ENGLISH. It used to be that when we talked about Ma Bell, we were talking about AT&T. We were talking about a company that as far as the metropolitan areas of this country, there wasn't anybody else.

That was the whale in the bathtub. But there was a void in the rural areas that Ma Bell didn't service. And that's where the REA came in. And that's the reason only 32 percent of the people had telephones in rural areas. And that's all the service we had back in 1949 when the REA started.

The difference comes in, if you've got one great big mammoth corporation and they're going to go out and install telephone equipment, that takes care of it. You don't need standards because that's one great big outfit. But whenever you've got numerous other small cooperatives and companies that are working through the REA, then if you're going to have any kind of network that fits together, you have to have standards.

The question is whether the situation has changed that much. Is AT&T still servicing and providing the development of new technology for the Bell companies? I think there's probably a pretty good indication that they're going to be doing that. That may not be true, though, of some of the rural areas.

Mr. HUNTER. Mr. Chairman, may I respond to that? Because I think you bring up a new realm of discussion that really fits in the need for further review, as you have very aptly indicated.

That is that the change in the AT&T structure is part of the reason that we're seeing a new environment that ought to be explored at the present time. Instead of a single AT&T, there are seven regional AT&T's, if you want to call them that.

There is going to be standardization. I think it will be a debacle, there will be unlimited confusion if there is not some type of standardization. But standardization is going to happen in those seven regional approaches to the telecommunications activity.

So if that's going to happen, this may be a very appropriate time for REA to be looking at the question, is there any way that REA can fit into that?

But I haven't come to a conclusion on whether or not there is a way it fits it, and I don't think anybody in REA has. But at least it seems to me that this ought to be explored.

The adjustment that the industry is going through at the present time may very well open the door to the consideration of this other function.

Mr. ENGLISH. But I guess we come right back to the same point. You may not have come to that conclusion, but your task force did. And that's in the report that they made.

And let me say one other thing very quickly. I think this may be exactly the wrong time to be considering such a thing because of the break-up of AT&T. Even the people within AT&T and the Bell companies can't tell you what's going to happen over the next few years as all the fallout comes down.

The thing that I'm concerned about, and I think that we all have to be concerned about, especially those of us from rural areas, is that with deregulation, the break-up of AT&T, and with other steps taken by the FCC, there is going to be less protection for those people living in rural areas. The emphasis is totally on competition.

It's going to be people in the major metropolitan areas that are going to get the benefits. The question is, will there be any protection for the people in the rural areas? And of course, that's where you all play a very important role.

Excuse me, Mr. Kindness, for taking so much time.

Mr. KINDNESS. Thank you, Mr. Chairman.

Actually I'm not sure that there hasn't been a gross amount of overstatement of the value of the standards setting function that we're talking about here on the one hand. There are non-REA borrowers in the rural cooperative telephone business that are getting along pretty well.

There are three in my district that are not currently REA borrowers. How do we get a specific assessment on an unbiased basis of the value of this standard setting function?

Do we get it from the people who are doing it? Do we get it from the people who are borrowing? How can you get a fair assessment of those standard setting functions and their value?

Mr. HUNTER. Mr. Kindness, you pursue a line of thought which I want to address and I want to address it in a careful way because it's sensitive.

The chairman made very appropriate reference to the statements, the opinions that were voiced in the study which was made by our task force.

I think a careful review of that task force study will reveal that there were multitudes of sources contacted to get opinions as to what ought to be done, if anything, with the REA standards. And out of this came a pretty strong feeling that REA should continue to develop and establish those standards.

Mr. **KINDNESS**. But isn't that traditional that when you study something that's in existence, the tendency is to not disestablish it, to not change it?

Mr. **HUNTER**. Particularly if those who are making the study are employees of the firm, the agency, that's doing the function. Particularly if those people that are reached and talked to have some reason to benefit by the continuance of REA's involvement in the standards function.

This is the reason that we have told the task force we wanted them to look further at some of those areas that are not using REA standards. And ask them how do they do it, how do they function, how can they be as extremely successful as they are?

The telephone program has been successful. It's been an excellent program under REA. But it's also an excellent program in the other 90 percent of the industry that exists across the Nation.

Mr. **KINDNESS**. I'd like to turn to this question of cost. Until this hearing was scheduled or the proposal was made to study the standards setting function, I guess maybe none of us realized just how valuable it was.

Has there been any information brought to your attention that suggests that anyone would object to putting it on a user fee basis?

Mr. **HUNTER**. Actually, I've heard individuals suggest that this might be one of the routes that should be pursued.

Again, I see that as being one of the options that should be within the purview of an expanded study.

Mr. **KINDNESS**. I'd like to turn to the general funds question for a moment. In what I've read in preparation for this hearing, the term "needed services," from the statutory language I believe, has cropped up a number of times.

Needed services are referred to without definition that I can find. Perhaps you could tell us now for the record whether there exists any regulatory or accepted definition of needed services.

For example, in some of the testimony that we received today, there's reference to CATV as in the category of needed services. I'm not sure that everyone would agree that that's a needed service. That is, it may be a very valuable service, and may be even in the category that people would say is certainly not a luxury.

But I'm not sure that within the statutory language that would be included within the definition of needed services. Is there a definition that you know of to which we could make reference for an understanding of that?

Mr. **HUNTER**. Let me make a remark or two in response to that. And then I'd ask Mr. Arnesen to respond more specifically and technically.

The changing business telecommunications market that we live in today points up the question as to what is essential and what is not essential, what is needed, what is not needed.

The changes that are coming about indicate the problems that the chairman referred to, and the industry itself is living with. It's a difficult time. It's a tough time for them.

As far as cable TV is concerned, there was a time a few years ago when REA was authorized to provide and to administer the financing for cable TV. At the present time it's not within our authority.

Of course, the authorizations for programs are contained within the language of the act itself. That gives us our thrust, our pursuit, or what we ought to do.

And also falls within the regulations that we have established through the administrative process. So, with that perhaps Mr. Arnesen might respond more specifically as to how they fit.

Mr. **Arnesen**. The term crops up in rural communities in that they feel that rural communities may need certain types of services. Now, CATV service is something that we cannot finance under the Rural Electrification Act.

But there may or may not be a desire on the part of residents of a particular community, either urban or rural, for something like CATV. And they feel in the industry that perhaps they should be filling a role that's not being met by someone else. With an opportunity to provide that type of service.

But under the law, we cannot provide financial assistance for providing services such as CATV.

Mr. **Kindness**. Now it comes back around in the argument from that point to where you're talking about general funds. And if there are assets tied up in the provision of services such as CATV, then that affects the application of the general funds doctrine, shall we call it, in terms of determining whether there's eligibility for a loan or for the draw down of funds on a previously approved loan.

So that the question of needed services does come back into the picture. The definition of it does come back into the picture; does it not?

Mr. **Arnesen**. Yes sir. And in this way.

The telephone borrowers have certain levels of general funds. And they would like to use them for certain purposes, one of which may be the provision of CATV services.

And the industry has talked to the Administrator about this issue for several years. And in looking at it, and being concerned about the security of REA loans, the Administrator thought that there perhaps was a way that this could be addressed.

And he decided that perhaps if a company or cooperative was in a strong enough financial position that it could pay dividends or retire capital credits under our mortgage provisions and policies—and they paid those dividends to stockholders, the stockholders could then do whatever they wanted with those dividends, including investing in CATV systems.

But rather than do that, many borrowers prefer to invest their funds directly in some of these services. The Administrator thought that perhaps this was a reasonable approach. He decided that if a company or cooperative could pay dividends or retire capital credits, and instead of doing that they wished to invest it in a project such as CATV, he felt that perhaps our loan security would not be adversely affected. And he would consider those on a case-by-case basis, which we're doing right now.

Mr. **Kindness**. Because in some cases there would be assets that would be valuable and wouldn't deteriorate the value of the security of the loan. But in other cases if they built the barn without a plan, the security might be diminished.

Mr. **Arnesen**. Right. And the Administrator has gone to the Federal Register with a proposed rule that would just set forth this method and procedure.

Mr. **Kindness**. Thank you. Thank you, Mr. Chairman.

Mr. **English**. Mr. Spratt.

Mr. **Spratt**. Thank you, Mr. Chairman.

Mr. Hunter, I've closed a lot of construction loans in my time and whenever I, as lender or as the attorney for a lender, accepted a mortgage and agreed to the terms of a construction loan agreement providing for future advances, I felt that I was bound by the terms of it so long as the borrower observed his covenants. I understand your rule with respect to general funds, to apply not just prospectively but also retrospectively. So that rural telephone cooperative borrowers who had existing loan agreements, in order to obtain further advances first must use all of their general funds in excess of 8 percent of the total telephone plan.

Is that true? And if so, how do you justify this apparent breach of an existing contract with your outstanding borrowers?

Mr. **Hunter**. It's true relating to the 8-percent restriction. That was in effect for how many years? A number of years. Since 19——

Mr. **Arnesen**. 1969.

Mr. **Spratt**. Was it in the loan agreement?

Mr. **Hunter**. It was not in the loan agreement. But it was in a published rule, which gives it credibility.

Mr. **Spratt**. Credibility? How about legal efficacy?

Mr. **Hunter**. Well, it's legal as part of a government activity. Whenever we publish a rule, it goes through the administrative process.

Mr. **Spratt**. Was this a regulation or a policy guideline? Does the loan agreement say that policy guidelines are hereby incorporated as a part of and made a covenant binding upon the borrower as a party to this agreement?

Mr. **Hunter**. It has been accepted for these many years as being applicable to the agreement and the provision of the loans that REA has the authority to make.

Mr. **Spratt**. Do you think you could use this authority to compel prepayment of outstanding loans?

Mr. **Hunter**. To compel prepayment of outstanding loans?

Mr. **Spratt**. You could compel the borrower who you find to have excess general funds? In excess of 8 percent of the total telephone plan?

Mr. **Hunter**. No.

Mr. **Spratt**. What's the difference?

Mr. **Hunter**. This is effective at the time of the request for loans or the request for an advance of funds.

Mr. **Spratt**. Under an existing agreement?

Mr. **Hunter**. That's right.

Mr. **Spratt**. How many loan applications, how many drawdowns under existing agreements do you have now pending which you have denied or cut back since the implementation of this policy? Or the adoption of this policy? The application of this policy?

Mr. **Hunter**. In other words, over the many years that——

Mr. **Spratt**. That you've decided to enforce this rule and apply it to existing borrowers who want to drawdown further funds. How many have you denied their full drawdown request based upon the general funds rule?

Mr. **Hunter**. Mr. Spratt, let me emphasize that we have not tightened the application of this rule in our present procedure. What we have gone to the Register with is a liberalization, a more flexible rule as to what a borrower can do with their general funds, and at the same time not put themselves in jeopardy by not being able to qualify for an advance of funds or for an application for a loan.

We have said to the borrower with this proposal that to the degree he is now eligible to distribute dividends or capital credits, he may use a similar amount of funds for the purpose of investment in telecommunications.

This is a benefit to the borrower and gives him the opportunity to diversify his investments. We think that's important for him.

When we look at the capability of the borrower to distribute dividends or capital funds, that provides to REA as a lender a measurement of how capable that borrower is, how strong his resources are.

Mr. **Spratt**. Let me give a hypothetical to you. Suppose a telephone borrower came to you and said, we know we have in excess of 8 percent of total telephone plan and what you define as general funds. However, we are accumulating funds here for an investment in a cable television system and we want to borrow additional funds. We don't have sufficient funds yet to go forward. We're setting aside these funds incrementally year by year. When we reach a certain level we'll then proceed with our investment. And right now we need some money, notwithstanding these reserves we're laying aside to invest in new telephone plans. Would the 8-percent rule still apply to them so that they couldn't get their full request?

Mr. **Hunter**. The 8-percent rule would apply except for that amount he intends to distribute as dividends or capital credits.

And those funds, if he desired to invest them in a cable television—we'll pick that as an example, a telecommunications type of endeavor—would not be counted against his general funds in the determination of his eligibility for the application for a loan or for an advance of funds.

Mr. **Spratt**. How many comments did you receive from your published requests for comments when you promulgated this regulation?

Mr. **Hunter**. I'm going to let Mr. Arnesen answer that. I'm sure he's more familiar with it.

Mr. **Spratt**. How many adverse and how many favorable?

Mr. **Arnesen**. We received comments on the proposed revision of our policy on general funds from three trade associations, extensive comments, about 17 or 18 pages each. And I'm only estimating now.

There may be a dozen or 15 companies that individually provided us with comments but I can't recall the specific number of companies or cooperatives that——

Mr. **Spratt**. One further question. When I first looked at this, and that was just this morning, at first blush I thought we were talking about working capital. As I read through these materials, general funds to me seems to be something broader than working capital and it seems to include assets much more liquid than current assets and what normally one would consider working capital.

Mr. **Hunter**. It would fall more in the category of liquid assets. And by definition it has to fall in the category which can be defined for accounting purposes.

Mr. **Spratt**. Are you attempting then to equate general funds to working capital and liquid assets? Is that the idea?

Mr. **Hunter**. I believe the answer to that is no. What we're talking about is liquid assets rather than working capital.

Mr. **Spratt**. You're talking about current assets then?

Mr. **Hunter**. That is right.

Mr. **Spratt**. I kind of equate the two in my mind. So I think we're using different notions.

But I've got here a copy of the objections filed by the trade associations. And it indicates that according to your definition, "general funds" includes investments in affiliated companies, advances to affiliated companies, other investments. As I read on, I find out that includes some telephone equipment that is leased out. And miscellaneous physical property. A lot of that I wouldn't call liquid assets.

Mr. **Arnesen**. That is correct. And certainly something such as an investment in an affiliated company may not be liquid if it constitutes stock for example. It may or may not be sellable. You are correct.

Miscellaneous physical property is something that we consider for exclusion when calculating appropriate general fund level for certain items. It's not a significant dollar amount on the balance sheets of our borrowers.

And we've revised our reporting form to kind of bring out specifically the amount of funds in that account so we can deal better and more fairly with it.

Mr. **Spratt**. So we aren't talking about—"general funds," then, does not equate exactly with "liquid assets" if we include these items in it.

Mr. **Arnesen**. It depends how you define liquid assets. Certainly if you have an amount of money in a savings bank, actually you would consider that liquid.

Mr. **Spratt**. I'll agree to that.

Mr. **Arnesen**. An item such as investments in affiliated companies, and it may constitute a loan to that affiliated company, or may include an investment of stock in that company, and it may or may not be liquid as a practical matter.

Mr. **Spratt**. Why call it "general funds" then? Don't we have a definitional problem?

Mr. **Arnesen**. Well, traditionally——

Mr. **Spratt**. They aren't funds. If you can't fund it, it's not funds. So I think you've included something in your definition that is contrary to the title, the category, the rubric.

Mr. **Hunter**. I'm going to ask Mr. Arnesen to listen to what I say and make sure I don't make a mistake because this does get technical.

In some cases, moneys have been taken from the general funds and invested in something that is not the purpose for which REA made the loans.

It could be some other extraneous type of investment. And it can very well be not very liquid. But at the same time it has diminished the general fund because it has been placed in that type of investment. And very possibly has within it the mix which includes borrowed moneys coming from REA.

And not out of any desire to cheat the Government, but merely because it's a good business practice on the part of the borrower, he very logically and very appropriately made that investment. But at the same time, that investment was made at his choice and may include moneys borrowed from REA.

Your reference to the process of changing the definition and changing the concept I think is well worth consideration. We have batted this around and tried to decide whether or not we ought to make another change. Change generally worries people.

But the purpose of our proposed change in general funds policy is to reduce the possibility that REA funds might be invested in something not included in REA's purpose.

Am I getting close to the point, Jack?

Mr. **Spratt**. If you take that into account, you've commended the cooperative for making the investment. It's good business sense, it's logical. Why penalize them now retrospectively when they didn't know at the time that it was going to be something that would get them into difficulty in terms of borrowing in the future?

Mr. **Hunter**. This restriction of 8 percent in this definition has been practiced for a lot of years. The change that we are now proposing and pursuing on a case-by-case basis really gives them more flexibility.

It gives them an opportunity to invest some moneys which previous to this change they could not have invested without it being counted against their general funds. It is the amount of money that they otherwise could distribute as dividends or capital credits.

The borrowers could do that anyway if they wanted to. They could distribute these moneys to their stockholders. And if the stockholders wanted in turn to come back and invest that money in this other activity which is not an act purpose. They could, but with our proposal it would be a telecommunications activity.

This is putting an unnecessary burden on the recipients of that dividend. We feel that it would be better for us to say to them that we recognize that this is an option they ought to have available to the cooperative or company.

Mr. **Spratt**. Thank you, Mr. Chairman.

Mr. **English**. Mr. Lightfoot?

Mr. **Lightfoot**. Thank you, Mr. Chairman. Mr. Hunter, I want to go back and replough some ground we've ploughed before. We'll try and refine it just a little.

It appears there are two basic arguments over whether telephone borrowers still need the REA to continue with the engineering standards function. There seems to be a lot of agreement among those who comply with those standards, including the borrowers, engineers, consultants and so on, that the function is vital to their ability to provide adequate service in today's market.

On the other hand, there's the question of whether or not establishing and enforcing these standards is even a proper role for the REA. And I think we talked about that at great length. But assuming that we took it out of REA hands and put it into the private sector, do you foresee any problems with enforcement of those standards if it's left to private industry without the force of the Federal agency or Federal regulations behind it?

Mr. **Hunter**. Enforcement becomes a part of the issue and I think needs separate consideration within the question of what we eventually do. There are some options.

One of the options would be that some entity in the private sector, would design, would select, would develop and would define the standards that must be met. And REA, in the granting of its loans, would require that those standards be met.

The other alternative would be that, as is happening now in the private sector with the great majority of those who serve America's telecommunications needs, there would not be a mandated, or required standard. The question comes up that this has been done for many years. Why change it now?

The larger question is, to what degree should government be involved in the things that can be accomplished somewhere else? And incidentally, this is being accomplished somewhere else. And I think we need more study of how that is being accomplished. To what degree are the security requirements of the lender being met? And to what degree does the lender look at standards that the other Bell Telephone Co. somewhere may be using in the building of their system?

Or to what degree do they say no, Mr. Borrower, what I want to know from you is how good is your management, how capable are you? Will you be providing good service? How do you answer, in the case of a co-op, your members? Will you recognize that the built-in discipline of the cooperative arrangement is such that the member that you serve is also your owner and you'd better provide him good service?

We would not want the security of REA loans, as long as they are being made, to be jeopardized. We would not want to jeopardize the capability of our borrowers to be able to obtain financing.

Mr. **Lightfoot**. On the subject of financing, the Grace Commission estimated that there's a savings of roughly $2 million in administrative costs that would result from eliminating the standards for both telephone and electric programs. And it's argued that such savings would be penny wise and pound foolish in comparison to the amount of money that would be saved in maintenance and construction if the standards were kept in place.

What's your viewpoint on those two arguments?

Mr. **Hunter**. Mr. Lightfoot, I would agree. I do not think this is an economic issue. There is not enough money involved to have a heavy impact upon the economy.

In the same sense, someone has said that you build a brick wall one brick at a time. And I think we deal with the overall budget problems of this Nation one brick at a time. If it amounts to only $2 million, or if it amounts to only $1 million, if it is something that can be handled by somebody in the private sector, and if that somebody in the private sector, instead of being a cost to the Federal Government might be a taxpayer on the profits that he makes from the venture, I think it's worthy of consideration. I think we need to look at it and review it.

Mr. LIGHTFOOT. Thank you.

Mr. ENGLISH. Mr. Miller.

Mr. MILLER. No questions.

Mr. ENGLISH. Harold, looking at some of the statements that you were making raises more questions in my mind than you've answered.

You indicated to Mr. Kindness that the people from the REA probably are going to be biased on any study they do, due to the fact that this might have some kind of impact on their job. And that raises the question, if you didn't have any faith in them, then why in the world did you have them do the study in the first place?

You come back and point out that cost is really not going to be a factor in this issue. But by the same token, if there is no standard, it could have a very detrimental impact on the users of this service. But there's nothing within this new direction that you've given for a new study that in any way indicates what the impact of eliminating these standards would be on private and business users under the REA.

It almost brings a person to the conclusion that perhaps the reason that we're having a new study is that you didn't like the answers you got on the last one. And I haven't really figured out exactly what the purpose is, perhaps, other than that. Are you trying to achieve some philosophical end that really doesn't have anything to do with cost, doesn't have anything to do with what's good for the people who use the service out there or what's good for the cooperatives? But philosphically you just don't like the way this thing works?

We agree that it's worked in the past. We agree that it's been necessary. We agree that you've got to have somebody setting these standards. But we just don't like who has done it. And nobody stepped forward to volunteer to do the job for us, or are even interested in doing this job from the private sector. But we believe that if we throw it out, maybe somebody will pop up.

That is generating a tremendous amount of risk, not only for the cooperatives, but certainly for the users of these services. Can you put some fears to rest in that area?

Mr. HUNTER. Mr. Chairman, I felt and I still feel that our first approach should be to analyze the concepts that we're dealing with—and remember what our thinking was. We felt there were three choices that ought to be examined. Each one of those have within them various options that could impact on our decision.

One of the alternatives would be to continue just like we've been doing. But again, if we're going to do that I think we need to review and make sure that's what we want to do.

Second was whether or not REA should just eliminate the standards function, mark it out of its books and let it go wherever it might go.

And the third one is whether or not REA should modify the standards function to some degree to meet the times and to respond to today's changes.

And an appropriate beginning in my mind was to find out specifically what the program is, find out and put in the record the pluses. The involvement of REA, the history of REA's involvement in standards setting. And nobody could do that better than somebody within our agency.

But at the same time, probably anybody at our agency has enough pride and enough inherent loyalty to the agency to be influenced, a little bit at least, by his response and even the way he asks the questions.

But I'm not challenging the integrity of the individuals. I'm merely recognizing the facts I had to anticipate, that this review would bring out a particular side of this picture.

Mr. ENGLISH. I guess the question arises then, why did you do it in the first place?

Mr. HUNTER. Because I felt that it ought to be on the record. I believe both sides ought to be developed and evaluated. And now I feel also that it ought to go further. The question of what options are available, should be explored in detail.

Mr. ENGLISH. If that was the case and we know that these guys are going to come back and say that we shouldn't make any changes, if we know that that's what it's going to be, then it seems to be a waste of the taxpayers' money, a waste of time. Because you already know what the conclusion is.

The second thing is, if that's what happened and you got just exactly what you expected, why was it kept secret? Why, was not this information released? Why, when you first went in with the study. did you lay this out and say we're going to ask these people to go out and do a study. This is what we're sure they're going to come back with because we know that they are biased.

That just doesn't make any sense.

Mr. HUNTER. I still feel that the data that they brought us, the presentations that they've made are a result of the current bulletins under which the agency is operating at the present time. This proposal of the administration brings into light a potential for something else that needs to be dealt with.

Probably in my mind one of the greatest tragedies that might happen would be if REA did not make any provisions for a logical, judicious approach to the adjustments that will be necessary within the industry, between now and that time our loan program might be discontinued.

And so the proposal of the administration does become a new factor, which puts a new light upon this issue.

Mr. ENGLISH. So you're directing the people conducting the study to proceed on the assumption that the President's budget request is going to be adopted. To proceed on the fact as if it has been adopted. Isn't that correct?

Mr. **Hunter**. They need to proceed on the possibility that it would be accomplished. Again, it can be very useful information for us through the years.

Mr. **English**. Have you been urged, told, requested to proceed on your actions as Administrator of the REA on the assumption that the President's budget will in fact be law?

Mr. **Hunter**. I've been urged both to proceed and also not to proceed on the——

Mr. **English**. Within the administration?

Mr. **Hunter**. It's been discussed. Various opinions have been promoted to me.

Mr. **English**. In the past it's always been the fact that actions would be based on law. Not based on the anticipation of law.

We've got some real problems with the Department of Agriculture. In the State of Oklahoma, the Farmer's Home Administration has made $10 million dollars worth of loan commitments. And we've only got $4 million dollars to cover them. And I've got to say I strongly suspect the reason that they don't have the money to cover that other $6 million dollars is that they've been told to assume this program is going to be zeroed out because the President's budget requested that it be zeroed out.

That's what the President requested. Is that the manner in which the Department of Agriculture and you are proceeding at the present time, is the assumption that the President's budget request will, in fact, be law?

Mr. **Hunter**. The assumption on which I am proceeding at the present time is that there is a possibility that it will happen. We have already provided part of a review. It is not complete because it has not probed what is being done in the private sector.

We want to know how the other companies that are not REA borrowers are able to survive and be profitable. And on the basis of that to make this review more complete. We are asking the task force to address those other issues.

Mr. **English**. Let me ask you one other question. Harold, you've been in politics for some time. You've been a State legislator. And you're very familiar. You've been the administrator of the ASCS office in Oklahoma.

In your political judgment, do you think there's a chance of a snowball in—you know where—that this program is going to be phased out by the Congress?

Mr. **Hunter**. Mr. Chairman, I think in light of the expression of the people of this Nation in this last election, there is a surprising support for the general purposes and general aims and general goals of this administration.

Mr. **English**. I didn't say general. I said this specific program to be zeroed out.

Mr. **Hunter**. Let me address that. I'm leading right toward that, sir.

One of the interesting things is that I see this President has been unbelievably successful in pursuing the things he really sets as his high priorities and goals. And definitely one of his high priorities is to deal with our budget, with the expenditures of the Federal Government.

And I would feel very strongly that there is a possibility and even a probability that he will be successful in this pursuit, even as he has been successful in some others that appeared absolutely impossible to achieve.

Mr. ENGLISH. Is it one of the President's high priorities to phase out the REA Program?

Mr. HUNTER. I noticed that the phasing out of the REA Program has stayed in the package that has been discussed over in the Senate. And has had some continuing agreement by both the White House and the Senate leadership.

I think that indicates something about how high a priority the dealing with REA is.

Mr. ENGLISH. So you assume that this is and to the best of your knowledge, this is a high priority with the President of the United States to phase out the REA Program?

Mr. HUNTER. I feel that definitely it is.

Mr. ENGLISH. Going back to the draft report, it lists benefits of standards to REA. Not to the cooperatives and not to the customers, the people out there that are being serviced, but to REA.

No. 1 on the list is: "Enhances loan security and provides a framework for increased financial viability to enable borrowers to obtain additional funding from sources other than REA."

That seems to be a pretty worthy goal. That's part of what these standards bring about. According to your people. No. 2: "Facilitates determinations that loan amounts are limited to the lowest level possible that still enables the accomplishment of program objectives; thereby, minimizing the possibility for waste and abuse of Government funds." That's one thing this subcommittee is mighty interested in: waste and abuse. We're not interested in promoting waste and abuse. We want to discourage it. According to your people, your survey that was conducted, that is one of the primary benefits to REA and the U.S. Government taxpayers.

No. 3: "Enables staffing requirements to be kept at a minimum level while maintaining the productivity and efficiency to meet the requirements set forth in existing policies and procedures." Pretty good goal. Not bad at all.

And last: "Allows program employees, nonengineers and engineers alike, who do not have construction and design experience, to carry out their program responsibilities."

Which brings me to another question. A lot of the telephone cooperatives in this country that are serving rural areas, that are serving areas that AT&T didn't want to service quite frankly, are really small operations. They're not AT&T's. And some only have two or three or four employees. That's what they consist of.

Now how in the world are they going to be able to maintain standards if the REA should abandon this field? How are they going to be able to make that kind of judgment? How are they going to have that expertise? How are they going to have the ability to deal with this problem?

Mr. HUNTER. Mr. Chairman, your questions and also your references just before you brought up the question bear out all the more, why there ought to be an indepth, effective, detailed review of how this is done in other parts of the industry, in those parts of

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the industry where there are no required standards, where there are no mandated standards, where there are no standards at a cost to the taxpayer, by the Government itself.

And this is the reason for the request to the task force to go further.

Mr. **English**. We still come back to the same thing. You've got these folks who you believe are biased to begin with, you knew what the conclusion was going to be, and they came up with these conclusions and now you want them to go out and do it over again.

I would also state that I doubt that in the REA and those employees dealing with telephone issues—that there's been any question in their mind as to what's taking place in the rest of the telephone industry in this country.

They've known all along what's taking place. They didn't need a study to tell them what's happening elsewhere in the Nation. They know exactly what's taking place in the system. They may not be able to tell you what's going to happen in the future anymore than anybody from AT&T is going to be able to tell you what's going to happen in the future with the breakup.

But, you didn't need a study for that. I have one last question for you. It's—we have received some reports that people on the task force that you appointed to study these standards are in trouble because their findings and recommendations didn't agree with your policy. Is that correct?

Mr. **Hunter**. Mr. Chairman, that is not correct, particularly if you are pointing at the reaction or the response of this agency to those employees.

I think they did it in good conscience. I think that if they didn't have a prejudice for the programs of REA and a prejudice for their own agency that it would not be a good reflection upon them. So, there is no intention, there is no criticism of them as individuals.

You might very well be correct that this might have been a poor assignment. But what they have done does not cast any reflection upon them or on their integrity as individuals.

We do feel that the process of how the review is made should be expanded and I think the that fact that we're going back to the same people, indicates to you, sir, that there is no lack of respect for their ability to bring to us information and data which will help us in our analysis, and that's what we are asking for.

Mr. **English**. The followup on that is, I suppose, will they be in trouble if their conclusions a second time around don't meet your beliefs?

Mr. **Hunter**. It will not. We might very well disregard their conclusions as contrasted to other conclusions that may be brought to us from some other source.

We're not going to expect them to make the decision, and we will respect them for their input for the integrity of the analysis, the data that they bring to us.

Mr. **English**. Will you make certain then that any study, whether by this group or any other group, takes into consideration the additional factors of the effect of eliminating the REA standards, the effect that that will have on the people who live and work in the rural areas and that are customers of these rural cooperatives?

Mr. **Hunter**. Mr. Chairman, this is a prime motivation in most of our decisions. We try to have it be the prime motivation always.

And, in my mind, one of the strongest things that could happen, one of the most beneficial things that could happen to the people at the end of our electric lines and the end of our telephone lines would be for this administration and this Congress to be a success. I know that the Congress, as well as the administration, is addressing itself to dealing with the problems within our economy.

Mr. English, you are involved in it very deeply because of your concern for the farm economy in Oklahoma and I commend you for it.

With the same breath, I think that we as an agency have a strong responsibility to help in diminishing the impact of government in those areas where it is not necessary, where it is not in the best interest of those people at the end of the line. That kind of government involvement becomes a burden upon the people that you and I are trying to serve.

So, Mr. Chairman, we definitely will be looking at this on the basis of the benefits or disadvantages to the people at the end of the line.

Mr. **English**. All right. We may have some additional written questions for you, Harold——

Mr. **Hunter**. We will be glad to respond.

Mr. **English** [continuing]. And we would appreciate your responding in a timely manner.

And, again, I guess the last question I have for you is, I still do not understand, if you are so sure that these people are going to be biased and the results of their study is not of value, why in the world did you have, not just one study, but you are going to have them do two?

Can you answer why in the world you had them do it in the first place and why you are having them do it a second time, if you don't—if you are not going to pay any attention to the conclusions?

Mr. **Hunter**. It comes right back to the emphasis I tried to make that we are not questioning the integrity of these people. We are recognizing that they, just like I, have a natural tendency to be influenced by their lives and by their experiences.

Let me mention how these people were selected, Mr. Chairman, because this becomes pertinent. They weren't selected blindly. We selected, I believe, seven people several months ago. I won't attempt to tell you the date.

These 7 people were selected out of 62 people who had applied for a training program to develop leadership, the stronger managers, the stronger people within the agency from a certain category of grade levels. Out of those 62 people that made application for it there were 7 people selected, and it was a process in which I did not involve myself, which was done through a committee process, by evaluation of their resumes they provided to that committee.

And, these four people on this committee were four out of that seven. We felt that it was a good way to use some selected people, some people who had expertise and motivation.

It had a twofold purpose. One of those is for the function that they would perform and, second, we felt it would be definitely a strong activity, a strong contribution to the training process in which they are involved.

Mr. **English**. Mr. Kindness, I think, had one additional question that he wanted to ask.

Mr. Kindness.

Mr. **Kindness**. Yes, Mr. Chairman, and I apologize for having had to be absent to attend another hearing in between, but—and perhaps this has been covered.

I was wondering if there has been any activity on the part of REA to improve oversight of borrowers with regard to this question that has come up, at least in the past, about whether borrowers are making proper application of the—proper use of the borrowed funds where apparently back in earlier years there was the suggestion at least that borrowed funds were being reinvested on a short-term basis to produce income—I guess in some cases maybe buying Government securities. They've got the low price, low interest rate loan and lend it back to the United States Government in effect with a few percentage points gain.

Is there a problem that exists in that area today and is there any action taken with—by REA to improve oversight with respect to the use of loan funds?

Mr. **Hunter**. Mr. Kindness, let me address that in two phases or two ways.

Let's address the real basis for the problem itself. The basis for the problem itself is that the opinion of the Administrator is that REA shouldn't be making loans at a 5-percent interest level. This is far, far, far away from what was being done 50 years ago in the electric program when borrowers borrowed money at 2 percent, which sounded like a bargain, you know. But, that money was only costing the Federal Government 1¾, 1½ percent. There was no subsidy as far as the cost of money. Back in the origination of the program when things were tough, even then, just like they are now, and also when the plants were being built, the systems were being built.

And, now we find ourselves with a situation where REA borrows its money, its funds from the Treasury and pays the cost to the treasury borrowing 10, 10.5, 11 maybe in some cases 12 percent, and turns around and loans it at 5 percent.

And, naturally there is a tremendous motivation upon any good manager not to be illegal, not to be crooked, but to manage his accounting systems in such a way that he can qualify for all of that 5-percent money that he can get. That's just good business.

REA feels very strongly that he ought to reinvest it. He should not let it lie in a checking account. That wouldn't be good business.

So, he invests those funds and makes a profit on that 5-percent money. That doesn't put the agency nor the industry in good light, nor is it a good use of Federal funds.

So, that's the basic problem behind our current working capital proposal. You ask, have we done anything? We have attempted, oh, over 3 years ago now, to approach the idea of how we change the ratios and criteria and utilization of 5-percent moneys.

Also, we feel very strongly that the 5-percent interest rate, which is set by law, should be corrected and adjusted and brought up to the cost of money.

So, that is the basic part of the problem.

Second, we have made some major changes in our auditing process in the field, and that has been done by requiring more and more use of CPA's. Again, some would interpret this as being a burden upon the borrower. But, again, we see it as a responsibility the borrower should accept.

And, it frees our own accountants, field auditors, to make more frequent visits, to get more to the detail of the things that are critical. The agency can accept the findings of the CPA's as a part of the auditing process.

These are two of the things that apply to your question.

Mr. **Kindness**. Where you use CPA's—independent accounting firms—is this the kind of procedure in which there is a review by a partner or someone in the firm other than just one CPA doing the audit and certifying it or is this a single operative-type of audit?

I'm thinking, for example, of the kind of situations that have existed—have come to light in some of these brokerage firms that are dealing in repurchase agreements where—one case down in Florida, the resident partner of a reputable accounting firm would certify the audit by himself and it sold for profit apparently, and that if it had been an SEC-regulated firm, would have required review by another partner in order to complete the certification.

Which type of function are we involved with here?

Mr. **Hunter**. You are addressing yourself to one of the major problems that we have and that is to make sure that the integrity and capability of that CPA is acceptable to REA.

We pursue that in several different ways. One of the things that we are looking at right now is the idea of providing that that CPA would be accredited—I guess would be the word—or maybe approved by a peer, a peer review of his capability.

This is a process that exists now within the CPA industry and has a high degree of credibility. There are some who are still arguing with us that this would be a burden that they feel would be—might not be worth the price. But, again, this is another route that we're pursuing to make sure that the type of a certification that we might receive from the CPA would be acceptable to REA.

The other thing that happens is that this more frequent visit by our own auditor is an opportunity for him to be more current as he makes a review of that CPA's report. So, I think the combination of these two things, a more frequent review from our own auditor plus the utilization of the CPA to a greater degree, has been and will be effective.

Mr. **Kindness**. Frankly, I'm wondering whether we are finding—whether you find in any number of circumstances that REA's or telephone co-ops are using—utilizing repurchase agreements as a way to manage short-term management of funds that are current funds.

Mr. **Hunter**. Mr. Arnesen, could you refer to the utilization question.

Mr. **Arnesen**. I think that has been done by some telephone companies and perhaps in cooperatives.

This is something we are looking at now as a policy item and we are reviewing our position on that, yes, sir.

Mr. **Kindness**. I don't mean to pronounce independent judgment. I have no right to do so, but it's a sophisticated kind of transaction that I think some—well, in Ohio some governmental entities as well as savings and loans have found to be a problem.

I think the protection of the co-ops is the responsibility of REA in light of these audits, and I certainly hope that the recent experiences could be brought to the attention of those borrowers from REA.

Mr. **Hunter**. I think the whole area of stress within the financing industry has brought us to a new realization of the importance of just what is the security behind various types of investments and some of them are not as good as we might, once upon a time, thought.

Mr. **Kindness**. Yes, well, you both sound like you're dealing in government securities, Uncle Sam's securities, but really you're dealing with contracts to purchase and sell. And, that's a very different proposition.

Thank you, gentlemen, and thank you, Mr. Chairman.

Mr. **English**. Thank you, and Mr. Hunter, I want to thank you.

There's one final question now that—seems like I keep coming up with one more, but you made the statement a minute ago that you thought that there were people in the REA that got these 5-percent loans, went out and invested them, made money off them at the expense of the Government.

I would like for you to provide this subcommittee with documentation of any case in which that's happened, No. 1, and, No. 2, I want to know whether you turned it to the Justice Department and whether they did anything with it because, as you well know, that is flat illegal.

And, if you knew about it and you didn't turn it to the Justice Department then I want you to tell this subcommittee why you didn't do that.

Mr. **Hunter**. Let me respond first by saying that we'll be glad to do that. We do have some documentation that's been provided to us. We will provide some of that to you, whatever we have.

The other point is that—coming back to my statement of a while ago, any time that borrower has some idle funds that he may be going to use in 30 or 60 days, I would feel it would be poor business on his part if he doesn't reinvest those funds for proper earnings.

Mr. **English**. It's illegal, isn't it?

Mr. **Hunter**. No, it's not illegal.

Mr. **English**. For him to use those funds?

Mr. **Hunter**. No, no; it is not. No, sir.

Mr. **English**. In other words, he can get a loan from you. He can go out and invest that money, make money off of it. Do whatever he wants to, and they're in great shape.

Mr. **Hunter**. I'll let Mr. Arnesen respond to that, but I'm quite certain——

Mr. **English**. I'd like to take a look at that one.

Mr. **Arnesen**. What we're talking about is a situation where a borrower has an approved loan from the Rural Electrification Administration. As part of his construction program he does a part of it with his own internally generated funds. What we call general funds.

And, at a certain point, he'll submit a requisition to REA for an advance under his approved loan, and if its general funds are under 8 percent we'll make the advance to cover what he had already spent, with his general funds and, of course, that money then moves from the construction fund account to his general fund account and then he's free to do whatever he wishes with that.

Mr. **English**. Is it now illegal for him to take that money, go out and invest that money and make money off it?

Mr. **Arnesen**. Under the scenario I just presented, it is not illegal.

Mr. **English**. Well, under the scenario that I'm laying out, isn't it?

Mr. **Arnesen**. Yes.

Mr. **English**. All right. It is flat illegal. So——

Mr. **Arnesen**. No, no sir. It's not illegal.

Mr. **English**. It is not illegal for that man to receive a loan, to go out and invest that money in some other purpose to make money for their cooperative?

Mr. **Arnesen**. No sir, that's not quite the scenario that we think we are addressing.

Mr. **English**. Well, what about the scenario I'm addressing?

Mr. **Arnesen**. All right.

Mr. **English**. Is that illegal?

Mr. **Arnesen**. We permit borrowers to—if we make an advance to a borrower who puts it in a construction fund account, we permit the borrower who is getting a Rural Telephone Bank loan, for example, to invest that temporarily if he has no immediate use for it within the next few days. He may have invested it like that.

Mr. **English**. Ah, you're permitting him to go out and make money off it.

Mr. **Arnesen**. Oh, yes.

Mr. **English**. I see.

Mr. **Arnesen**. But, not the low interest money.

But, the scenario that's the common scenario is that a borrower, and this occurs in both the electric and telephone program, will receive a loan for specific purposes to do certain types of construction. Now, rather than constantly submit requisitions to REA he may do certain construction with his own funds, and at a certain point in time will submit a request for an advance under that loan and we will make the advance. He'll put it in his construction fund account, and then he can transfer it to his general fund account. This is perfectly legal, and——

Mr. **English**. Is it appropriate?

Mr. **Arnesen**. Of course.

Mr. **English**. All right, then why did Mr. Hunter bring it up?

Mr. **Arnesen**. Well, the question is, it gets back to level. For example, when we have the level of 8 percent—I suppose if we had no level and that company might have 20, 40, 50 percent——

Mr. **English**. That isn't the light in which Mr. Hunter presented it.

The manner in which he presented it was: We've got this 5-percent money, we're making loans to telephone borrowers and they're taking that 5-percent money and making money off it at the expense of the Government.

Now, that is the manner in which Mr. Hunter stated it.

Mr. Arnesen. Well, but I qualified it.

Mr. Kindness. I want to straighten out the record here.

If we're speaking about the response to the question I presented to Mr. Hunter, I sure didn't hear it that way. If we go back I suppose we could——

Mr. Hunter. Mr. Chairman, I feel that I did and if didn't I intended at least to qualify it. I would criticize that good manager out there that left money that was idle and not have it invested and drawing interest, just for poor management.

Mr. English. All right. But, the point that we're making, is that if anyone takes 5-percent loans, then goes out and invests it for the purpose of making money, not to let it set there and hold it in his bank to spend it on the construction of building but to hold that to make money that would not be legal. Is that correct? In other words, he's defrauding the Government if he's using it for that purpose, is it not?

Mr. Arnesen. If we advanced money to a borrower who then turned around and invested that money just to make money, yes, I would suspect that you are correct, and——

Mr. English. All right.

And, then, on the other hand, the other side of the issue, if the man is simply holding it in his bank account, not spending, and that is earning interest, as such, then that is what Mr. Hunter considers to be good management; correct?

Mr. Hunter. The point is that if he borrows it at 5 percent, you know, and loans it out and gets 12 percent, it's good management.

My point is I was not criticizing the manager. I was not criticizing the borrower. I was criticizing the fact that this Government, this REA is loaning money at 5-percent interest rate, which really becomes a motivation to use that type of management, and I don't believe that there is a need——

Mr. English. But, that's not the purpose for the money, Mr. Hunter, and you and the REA have the responsibility, through the rules, regulation and the management of that agency, then to oversee that——

Mr. Hunter. Precisely.

Mr. English. The point is, if you are loaning 5-percent money to people and you suspect they are misusing it, then maybe you better have a little stronger oversight of your operation than you've had in the past. Maybe you ought to change a few of the rules and regulations if you think that people are taking advantage of the Government to that extent.

The purpose of the 5-percent money is to help in the construction. It's not out there to assist people in making money. If you think they're taking advantage of the program then I would suggest you've got plenty of authority under the law to deal with that, the problem, to tighten up your operation and your management of the program to make sure that doesn't take place.

Mr. Hunter. And, Mr. Chairman, that is the purpose. That is the goal. That's the aim of the restrictions on the general funds, the amount of the general funds, that are allowable for an REA borrower to have on hand when he reaches back and borrows again from REA. That's one of the purposes. That is the purpose.

Mr. **English**. But, the criticism is on the 5-percent money.

Mr. **Hunter**. My criticism is that the 5-percent money becomes inherently a temptation or a goal to work towards and not that he's going to do it illegally or anything like that. But, it's not in the best interest.

Mr. **English**. But, we would urge strong oversight, on your part then, Mr. Hunter.

Thank you very much. Thank you, again, Mr. Hunter.

As I said, we may have some written questions for you.

Mr. **Hunter**. Be glad to respond, sir.

Mr. **English**. Thank you very much.

Mr. **Hunter**. Thank you, sir.

Mr. **English**. OK, next we'll have two witnesses on a panel.

Mr. Gary Kennedy of Panhandle Telephone Cooperative of Guymon, OK, and he's representing the National Telephone Cooperative Association, and Mr. John F. O'Neal, who is counsel for the National Rural Telecom Association of Washington, DC.

Gary, I want to welcome you and John. Joe Vellone, special counsel of the National Telephone Cooperative Association, is going to accompany Gary.

Gary, we'll let you start off the testimony today, if you would.

STATEMENT OF GARY KENNEDY, MANAGER, PANHANDLE TELEPHONE COOPERATIVE, INC., ACCOMPANIED BY JOSEPH VELLONE, NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

Mr. **Kennedy**. Chairman English, members of the subcommittee, my name is Gary Kennedy. I am the manager of Panhandle Telephone Cooperative, Inc., in Guymon, OK.

We serve approximately 4,000 subscribers in a very sparsely populated area of western Oklahoma. In our service territory we have fewer than two subscribers per route mile of telephone lines.

Today I am also speaking on behalf of the National Telephone Cooperative Association. NTCA represents more than 450 locally owned and operated small, rural telephone systems in over 40 States.

I sincerely appreciate the opportunity to testify this morning in support of the preservation of REA's engineering standards divisions, in both the telephone and electric programs.

The REA standards function is the heart of the REA program. The administration's proposal to eliminate REA standards responsibility poses a serious threat to small rural telephone systems like Panhandle and jeopardizes affordable telephone rates.

As you know, Mr. Chairman, telephone plant facilities constructed with REA funds must conform to specifications, established by REA's Telecommunications, Engineering and Standards Division.

We welcome this requirement, which has minimized our construction costs and improved the quality of our facilities as well.

High quality equipment and construction means the facilities are more effective and have a longer life. High quality facilities improve the Government's security because the borrower can generate revenues over a longer period before the facilities need to be replaced.

Standarization, therefore, serves the interest of all the telephone systems, and their customers, and also protects the Government's security. It makes sense then for REA to continue to set technical standards for rural telephone system plant facilities because the agency has an invaluable experience in addressing the problems inherent in serving sparsely populated areas. Over the years REA has encouraged manufacturers to respond positively to the needs of the rural telephone industry.

Why should REA rather than a nongovernment entity set standards? Primarily, it is REA's enforcement authority which makes for an effective standard setting program, and only REA can provide an unbiased approach to setting important industry standards for rural telephony.

Mr. Chairman, all parties operating under REA standards of borrowers, the consulting engineers, the construction contractors and the equipment manufacturers want, and need, REA to continue to establish technical and engineering standards.

Since REA standards reduce cost to the Government and the rate payers, it is difficult to understand why the Department of Agriculture would advocate abolishing the REA Standards Division.

The pending proposal to relinquish standard setting responsibilities is shortsighted at best. At worst it is part of a larger plan to eliminate REA altogether and thereby turn back the clock on affordable rural phone service.

It is no secret that this administration has been trying to do away with REA. OMB's budget proposal for fiscal year 1986 included a phase out of REA programs by September 1989, and a tremendous increase in interest rates for insured loans, virtually ensuring a rise in rural telephone rates.

At this time in the history of the telephone industry, a time of dramatic and often difficult change, REA telephone borrowers certainly cannot afford to see the REA standards program weakened or eliminated. I strongly urge this subcommittee to rebuff the attacks on REA and instead recommend that REA continue to set technical engineering standards for the telephone and electric program.

The REA Standards Division provides services that are vital to rural America. Those services are as important today as they were when the REA program began more than 40 years ago.

Mr. Chairman, the next witness will address an issue which is also of great concern to NTCA, the REA general funds policy. This policy is illegally and unfairly restricting REA borrowers eligible for loan funds from obtaining REA loans.

TCA submitted comments on REA's 1983 proposed changes in its general fund policy, changes which would solidify REA's restrictive policies. After 2 years, the matter is still pending.

With the chairman's persmission, I would like to submit NTCA's comments on REA general fund policy for the record.

Mr. ENGLISH. Without objection, so ordered.

[See app. 3.]

Mr. KENNEDY. Thank you, Mr. Chairman, and members of the subcommittee for permitting me to ask your support for the REA engineering standards programs, which are of vital importance to small, rural telephone systems like Panhandle and to rural telephone customers throughout the Nation.

Thank you.

[The prepared statement of Mr. Kennedy follows:]

Testimony

of

Gary Kennedy, Manager

Panhandle Telephone Cooperative, Inc.

on behalf of

The National Telephone Cooperative Association

Before the

House of Representatives

Government Affairs Subcommittee

on

Government Information, Justice and Agriculture

April 18, 1985

Chairman English, members of the Subcommittee, my name is Gary Kennedy. I am the Manager of Panhandle Telephone Cooperative, Inc. in Guymon, Oklahoma. We serve approximately 4,000 subscribers in a very sparsely populated area of western Oklahoma. In our service territory, we have fewer than 2 subscribers per route mile of telephone line. Today I am also speaking on behalf of the National Telephone Cooperative Association. NTCA represents over 450 locally owned and operated small, rural telephone systems in over 40 states. Most of NTCA's members have obtained financing from the Rural Electrification Administration and the Rural Telephone Bank.

I sincerely appreciate the opportunity to testify this morning on an issue of grave importance to NTCA and the rural telephone subscribers we serve. That issue is the preservation of REA's engineering standards responsibilities in both the telephone and electric programs. REA's standards functions are the heart of the REA programs and are largely responsible for REA's phenomenal record of bringing affordable telephone service to rural America. We strongly oppose the Administration's proposal to eliminate these functions and the telephone and electric engineering staffs responsible for them. Without REA's assistance in establishing technical and engineering standards for the design, construction, and maintenance of telephone facilities, construction costs to rural telephone systems like Panhandle would increase substantially and the quality of service would decline.

As you know, Mr. Chairman, telephone plant facilities constructed with REA funds must conform to specifications, established by REA's Telecommunications, Engineering and Standards Division. We welcome this requirement, which has minimized our construction costs, and improved the quality of our facilities as well.

REA's standards enable us to contain our costs for several reasons. First, we provide a volume market for equipment manufacturers. Second, the costs of standardized construction and equipment installation are lower. And third, standard construction units and specifications allow for truly competitive construction bids from contractors. Standardization also cuts down on telephone system operating costs by increasing the efficiency of system maintenance. Moreover, standardization increases the productivity of telephone system employees and reduces training costs. Thus, a valuable pool of talent is available because of standardization to fill vacancies and to help restore service in emergencies nationwide.

Equally important, REA standards provide quality control, which also contributes to cost savings. High quality facilities will be more efficient and have a longer life. The government's investment is better protected since borrowers can generate revenues over a longer period before the facilities need to be replaced. Standardization, therefore, serves the interest of the telephone system and its customers and also protects the government's security.

The Power and Communication Contractors Association (PCCA) indicated in testimony before the Senate Agriculture Subcommittee on Agricultural Credit and Rural Electrification last year that, due to REA standardization, the cost of constructing a rural utility is reduced by between 5percent and 9 percent. This represents an average savings of $25 million to $45 million a year in the telephone program alone -- a monumental savings, considering it costs only $1.2 million a year to maintain the standards division for the the telephone programs. In fact, REA's standards functions may be the best investment the federal government has ever made.

The Association of Communications Engineers (ACE) is also on record as opposing the proposed elimination of the Telecommunications Engineering and Standards Division. In a letter to the Agriculture Department's Undersecretary for Rural Development, ACE voiced its support for the REA Standards Division, based on its 27-year working relationship with REA.

REA standards are as important today as ever. At Panhandle, we rely heavily on REA's "Telephone Engineering and Construction Manual" and its "List of Acceptable Materials for Use on Telephone Systems of REA Borrowers" to keep up with technological developments in telephone plant and equipment. These publications, prepared by REA Engineers, cover all aspects of rural telephone system design, including outside plant construction, switching systems, transmission systems, lightning protection and system design. They are the only comprehensive publications of this type for rural telephone systems.

Here is an example of how REA standards meet Panhandle's needs: a number of our longer loops require electronic loop extenders so as to reach distant subscribers. In the near future we will utilize a new design of loop extender for our new digital switching equipment on a field trial basis. REA engineers will monitor the performance capability. If performance is satisfactory during the trial period, REA will accept them for general use.

It makes eminent good sense that REA, in the interest of loan security and reducing program costs, continue to set technical standards because the agency has invaluable experience in addressing the problems inherent in serving sparsely populated areas. Over the years, REA has encouraged manufacturers to respond positively to the needs of the rural telephone industry. Moreover, the REA standards division is responsive to any borrower complaints about faulty material, equipment or construction. That so few complaints over the years have required REA to enforce its powers reaffirms the high caliber of work that REA's standards divisions perform before acceptance of equipment, designs or materials for use by REA borrowers.

The REA standards functions are especially important today when the telephone industry is in a tremendous state of flux. Rural telephony needs a strong REA standards program in order to survive in the present deregulatory environment. To remain competitive and, indeed, financially viable, REA borrowers need to be kept abreast of technological advances in the industry. REA standards are crucial to monitoring industry changes.

Eliminating or reducing REA's standards responsibilities would decrease both the efficiency of REA borrowers and the quality of telephone service in rural areas while construction costs would rise. REA, in cooperation with small, rural telephone systems, has worked hard to achieve the high quality of telephone service rural Americans now enjoy. REA telephone borrowers simply cannot afford to see the REA standards program weakened or eliminated. It could mean a fatal blow to many REA telephone borrowers.

Why should REA and not a non-government entity establish industry standards? Primarily, it is REA's enforcement authority which makes an effective standards setting program possible. To obtain an REA loan, the borrower must adhere to REA standards. A private entity's standards would not have the force of law behind them. Moreover, the responsibility for standards should not be placed in the hands of organizations with conflicting telecommunications interests. Only REA can provide an unbiased approach to setting important industry standards for rural telephony. REA offers the same high level of technical expertise to all borrowers-- regardless of their size. REA's only interest-- in fact its legal mandate-- is to promote the interests of rural telephone subscribers.

Mr. Chairman, all parties operating under REA standards-- the borrowers, the consulting engineers, the construction contractors, and the equipment manufacturers - want and need REA to continue establishing engineering standards. Considering that REA standards reduce costs to the government and the ratepayers, it is difficult to understand why the Department of Agriculture would advocate abolishing its engineering standards functions. The pending proposal to relinquish standards-setting responsibilities is shortsighted at best. At worst, it is part of a larger plan to eliminate REA and thereby turn back the clock on affordable rural phone service. It is no secret that this Administration has been trying to do away with REA. OMB's budget proposal for fiscal year 1986 included a phase-out of REA programs by September, 1989 and a tremendous increase in interest rates for insured loans, virtually ensuring prohibitive rates for rural telephone users.

I strongly urge this subcommittee to rebuff the attacks on REA, and instead recommend that REA continue to set technical and engineering standards for the telephone and electric programs. REA's standards divisions provide a service that is as vital to rural America today, as it was when the REA program began over forty years ago.

Mr. Chairman, the other member of this panel will address another issue of great concern to NTCA: REA's general funds policy. This policy makes many REA borrowers ineligible for loans and loan advances under non-statutory criteria inconsistent with the Rural Electrification Act, loan contracts and court decisions. NTCA submitted comments in 1983 on REA's proposed changes in its general funds policy that would solidify these restrictions. After two years the matter is still pending. With the Chairman's permission, I wish to submit NTCA's attached comments on REA's proposed regulation of general funds for the record.

Thank you, Mr. Chairman and members of the subcommittee, for permitting me to ask your support for continuation of REA's engineering standards functions which are vitally important to small, rural telephone systems like Panhandle, and to rural telephone customers throughout the nation.

Attachment

Mr. **English**. Thank you, Mr. Kennedy.
Mr. O'Neal.

STATEMENT OF JOHN F. O'NEAL, GENERAL COUNSEL, NATIONAL RURAL TELECOM ASSOCIATION

Mr. **O'Neal**. Thank you, Mr. Chairman. It's always a pleasure to appear before this committee and I appreciate the opportunity to be here today.

Undoubtedly, the most vexing problem currently facing rural telephone borrowers is the so-called general funds policy of REA and its proposed revision. For that reason I particularly appreciate the opportunity, on behalf of the National Rural Telecom Association, to testify on this important subject and join our sister organization, the National Telephone Cooperative Association, on this panel.

Our association's primary focus is the representation of commercial REA telephone companies, while NTCA's primary responsibility is to cooperative-type borrowers. Together we represent about two-thirds of all REA borrowers, and we work very closely on matters affecting our mutual interests.

Our association shares NTCA's views on the impact of the proposal to eliminate the engineering standards function of REA and I know it supports the thoughts which I will express to the committee here today on the issue of general funds.

The general funds policy has existed in one form or another since 1962. It was originally adopted as a guideline in reaction to an admonition from the House Appropriations Committee that REA should determine a proper level of reserve for each applicant and make certain that loan funds are used for the purposes for which they are made available.

That statement of congressional policy, with which no one can argue, was in response to charges that REA borrowers were accepting 2-percent loan funds and reinvesting them in higher yielding government bonds.

Of course, if this occurred, it would constitute a violation of Federal criminal statutes and the penalties which would attach would seem to be a sufficient deterrent without the need for a separate guideline from the lending agency, but nonetheless the policy was adopted.

The subcommittee should note that the House Government Operations Committee in another matter involving REA administrative actions determined that the REA Administrator abused his authority in issuing the bulletin of May 19, 1969. He has no authority to enforce either Federal or State criminal laws, he has no right to use his lending and contract authority to impose punishments for acts unrelated to the borrower's obligation to repay the loan; and he has improperly intruded upon the basic right of citizens to engage in political activities. Even if he has the power to do those things, there was no factual justification for the bulletin. (H. Rept. No. 91-550, 91st Cong., 1st sess.)

Other than the difference in subject matter, the committee's conclusions would apply to the general funds policy as it is being implemented today. In its original form the "appropriate general funds level" was 20 percent. It has been modified over the years and was subsequently reduced to 8 percent in 1969. At the same time, provisions in the loan contract related to general funds were dropped so the only basis for the current restrictions is the general funds bulletin itself.

On June 24, 1983 the current Administrator proposed revising the policy and for the first time incorporating it in its revised form in the Code of Federal Regulations as a legally binding rule. This association, along with NTCA, submitted comments on August 23, 1983, opposing that rule and asking that the policy be rescinded.

Mr. Chairman, may these comments, be included in the record of this hearing as well?

Mr. ENGLISH. Without objection, so ordered.

[See app. 3.]

Mr. O'NEAL. Thank you, sir.

No final action has yet occurred on this proposal. The proposed rule states:

> This rule sets forth REA policy on general funds of REA Telephone borrowers and establishes the appropriate level of working capital and reserve funds for use by borrowers and REA in approving loans, loan guarantees, and loan funds advances. It is REA policy that general funds in excess of the appropriate level shall be applied to uses which conserve REA loan funds.

And further:

> As a condition to futher advances of loan funds or approval of a loan, borrowers whose general funds exceed the greater of $100,000 or eight percent of total telephone plant—the appropriate general funds level—shall be required to use this excess to supplement loan funds for approved loan purposes, except as otherwise authorized by the Administrator of REA.

By definition, the term "loan funds" means "the cash advanced to the borrower under loans made or guaranteed under the REA Act." Loan funds are treated separately in the proposed rule and are excluded from the definition of "general funds."

"General funds means all cash and investments not held in trustee or similar accounts as required by loan contract or security instruments and normally includes the balances of," and then it lists a number of specified accounts.

So, what we now have is the Government moving to adopt a rule restricting the accumulation and use of a borrower's own money in connection with a Federal loan program based upon a perceived abuse over 20 years ago originating solely with the use of Government loan funds.

Mr. Chairman, if this hearing had been held in 1984 it would have made George Orwell look like a prophet.

But, it is even more bizzare. Not only is Government seeking to restrict the flow of loan funds based upon this arbitrary test of the accumulation or use of borrower's own funds, under the rule they would also seek to require the borrower to apply any of its own "excess" funds "to supplement loan funds for approved loans purposes" if they are ever again to draw down loan funds from REA.

Let's look at the act to determine the authority for such a far reaching regulation. There is no reference in the proposal to a specific authorizing provision in the act—so there is no help there.

In reviewing the act, however, we find that the Administrator does not have the boilerplate rulemaking authority contained in many congressional acts which would permit him to adopt whatever rules are necessary to carry out the purposes of the act. But, that is not surprising, since REA is a lending agency and not a regulatory agency and that is a provision normally associated with regulatory authority.

Unless it intends to proceed further and intrude into the everyday business affairs of borrowers, all the agency needs to administer the act is a well written loan contract. That conclusion is confirmed in section 4, which by authorizing in specific terms, limits the Administrator's discretion to attach conditions on loans to those expressed in the following proviso:

> Such loans shall be on such terms and conditions relating to the expenditure of moneys loaned and the security therefor as the Administrator shall determine.

On the other hand, the act states in section 305:

> The Administrator is authorized to make insured loans under this title and at the interest rates hereinafter provided to the full extent of the assets available in the fund, subject only to limitations as to amounts authorized for loans and advances as may be from time to time imposed by the Congress of the United States for loans to be made in any one year.

That the Administrator must make loans to all qualified applicants has been confirmed by the courts in the *Sioux Valley* case (*Sioux Valley Empire Electric Association, Inc.* v. *Earl L. Butz,* U.S. District Court, Nov. 29, 1973, 367 FED. Supp. 686, affirmed at 504 F.R. 2nd 168) which stated in interpreting the REA Act:

> The Secretary has the nondiscretionary duty to make the loans to qualified applicants.

It also indicates further:

> The Administrator's discretion is limited to the determination of qualifications.

These references lead to the inescapable conclusion that the Administrator simply does not have the requisite authority to adopt such a restriction on borrowers. That the Administrator may have reached a similar conclusion might explain why he has not finally acted on the proposal even though it has been pending since August of 1983. I believe that out of all of the comments received, none recommended adoption of the proposal.

REA has stated in the meantime that it will consider requests on a case-by-case basis, as if the rule were final. This puts borrowers in a classic catch-22 situation. They are victimized by the rule as if it were in effect, but may have difficulty challenging it in the courts until final action occurs. This should not, however, preclude challenging the present policy as one inconsistent with the provisions of the Rural Electrification Act, appropriations act, loan contracts, and relevant court decisions.

There have been efforts made to justify the rule on the theory of protecting the Government's loan security. But, a lender generally tries to enforce measures designed to enhance the borrower's financial status to protect his loan, and not the other way around, as this rule would require. The proposal would actually discourage borrowers from accumulating general funds and therefore making the Government's security less attractive since the 8 percent represents a maximum rather than a minimum requirement. Also, the proposed rule is not drafted in keeping with "generally accepted accounting principles" since the calculation involves noncash items and would treat assets which represent cash expended in prior years in the same way as cash in the bank.

The Administration, rather than relying on the original Appropriations Committee report language, has chosen instead to defend the proposal on the basis that it is necessary because many of the borrowers are successful financially and should not be permitted access to low-cost-loan funds from REA. In other words, a regulatory device to ration credit to those systems deemed to be "worthy" in the eyes of the Administrator.

Mr. Chairman, there is no basis in the REA Act for such a proposition. What the Administrator is seeking is to amend the act administratively without congressional approval and adopt a threshold "means" or "needs" test. Congress specifically rejected such a concept in 1973 when the act underwent its last major overhaul. And, Congress did it for a very good reason.

The REA Act is not today and it never has been a company welfare program. These borrowers are public utilities, all of which are subject to ratemaking regulations under State law. As such, benefits from low-cost REA financing are passed directly through to the subscribers in the form of better service and lower rates, which is exactly what Congress intended.

This is a program for people, not companies. The companies are merely the vehicles which Congress has employed to accomplish the act's purposes. Telephone companies from the largest Bell operating companies down to the smallest telephone system are equally entitled to REA funds if they meet the act's eligibility tests—serve a rural area (1,500 population or less)—and are willing to accept the act's obligations to serve the "widest practical number of users" in their service territory. This is a standard which REA vigorously enforces.

If a needs test is adopted, it should be accomplished through the established congressional processes for amending legislation, not by administrative fiat. And in my judgment, if Congress believes that such a test is needed, it should be based upon the cost of providing service in the territory being served, not on the revenues or the financial status of the company providing that service.

That is the "need" that Congress was addressing when it passed the REA Act. And, the cost of providing that service, Mr. Chairman, as you well know, is substantially greater today than it was in 1949.

The more accurate basis for judging the continuing need for and value of this program is whether, as a matter of national policy, rural America will continue to enjoy comparable telephone service at reasonably comparable rates with our urban society. This committee more than any other in the Congress because you have tracked the issues so carefully in the past 2 years understands the needs for targeted assistance to high cost rural telephone services areas.

You also understand the terrific pressure which already exists on rural telephone rates and service caused by recent FCC and court actions.

The REA Program provides just such a mechanism for targeted assistance to rural areas. It is a loan program with a record of accomplishment unequaled in Government and it is as needed today as it was in 1949. But, if the program is to continue to accomplish its mission it must not be fettered with unreasonable or unnecessary borrower restrictions or regulations.

Many borrowers are already finding the current administration of the program too burdensome. An increasing number of borrowers are being precluded from receiving loans or from drawing down approved loan funds because of the general fund's policy.

Last year, for the first time in history, REA failed significantly to meet the minimum loan levels set by the Congress even though there was a substantial backlog of completed applications at the agency. At the same time, there is also a backlog of over $750 million in approved but unadvanced telephone loans.

The primary reason for these problems very simply is the restrictive REA general funds policy. There are adequate restrictions now in place to assure that loan funds go for their intended purposes, and if there are abuses, then punish the abusers but not all rural telephone systems.

So far none have been cited, Mr. Chairman.

I can only conclude that the Administrator is using this policy as a device to reduce loan levels in violation of the intent of Congress. The fact is that borrowers are not being permitted to do the job Congress intended because of an arbitrary administrative policy which the agency now proposes to make a binding regulation.

It must be rescinded if congressional objectives for the REA program are to be fulfilled for rural America. Otherwise, the annual loan levels, based upon program needs, set by the Congress through the appropriations process are meaningless.

Thank you very much.

[The prepared statement of Mr. O'Neal follows:]

STATEMENT
OF
JOHN F. O'NEAL
GENERAL COUNSEL
NATIONAL RURAL TELECOM ASSOCIATION

CONCERNING THE RURAL ELECTRIFICATION ADMINISTRATION PROPOSALS TO
REVISE REA BULLETIN 300-5, "GENERAL FUNDS (TELEPHONE PROGRAM)"
BEFORE THE
SUBCOMMITTEE ON GOVERNMENT INFORMATION,
JUSTICE AND AGRICULTURE OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
U.S. HOUSE OF REPRESENTATIVES

PUBLIC HEARING ON
FEDERAL PROPOSALS IMPACTING RURAL TELEPHONE SYSTEMS
THURSDAY, APRIL 18, 1985

Mr. Chairman and Members of the Committee:
Undoubtedly, the most vexing problem currently facing rural telephone borrowers is the so-called "general funds" policy of REA and its proposed revision. For that reason, I particularly appreciate the opportunity to appear before you today on behalf of the National Rural Telecom Association and to join with our sister organization, the National Telephone Cooperative Association on this panel. Our association's primary focus is the representation of commercial REA telephone companies while NTCA's primary responsibility is to cooperative type borrowers. Together we represent about two-thirds of

all REA borrowers and we work very closely on matters affecting our mutual interests. Our association shares NTCA's views on the impact of the proposal to eliminate the engineering standards function of REA and I know it supports the thoughts which I will express to the Committee here today on the issue of general funds.

Background

The general funds policy has existed in one form or another since 1962. It was originally adopted as a "guideline" in reaction to an admonition (House Report 448, 87th Congress, 1st Session) from the House Appropriations Committee that REA should determine a proper level of reserve for each applicant and make certain that funds are used for the purposes for which they are made available.

That statement of Congressional policy, with which no one can argue, was in response to charges that REA borrowers were accepting 2 percent loan funds and reinvesting them in higher yielding government bonds. Of course, if this occurred it would constitute a violation of federal criminal statutes and the penalties which would attach would seem to be a sufficient deterrent without the need for a separate guideline from the lending agency but, nonetheless, the policy was adopted. The subcommittee should note that the House Government Operations Committee in another matter involving REA administrative actions determined that "The REA Administrator abused his authority in issuing the bulletin of May 19, 1969. He has no authority to enforce either Federal or State criminal laws; he has no right to use his lending and contract authority to impose punishments for acts unrelated to the borrower's obligation to repay the loan; and he has improperly intruded upon the basic right of citizens to engage in political activities. Even if he has the power to do those things, there was no factual justification for the bulletin." (House Report No. 91-550, 91st Congress, 1st Session) Other than the difference in subject matter, the Committee's conclusions would apply to the general funds policy as it is being implemented today. In its original form, the "appropriate general funds level" was 20 percent. It has been modified over the years and was subsequently reduced to 8 percent in 1969. At the same time, provisions in the loan contract related to general funds were dropped so the only basis for the current restrictions is the general funds bulletin itself.

On June 24, 1983, the current Administrator proposed revising the policy and, for the first time, incorporating it in its revised form in the code of Federal Regulations as a legally binding rule. This association submitted comments on August 23, 1983, opposing the rule and asking that the policy be rescinded. May these comments be included in the record of this hearing? No final action has yet occurred.

Proposed Regulation

The proposed rule states:

> "This (rule) sets forth REA policy on general funds of REA Telephone borrowers and establishes the appropriate level of working capital and reserve funds for use by borrowers and REA in approving loans, loan guarantees, and loan funds advances. It is REA policy that general funds in excess of the appropriate level shall be applied to uses which conserve REA loan funds."

and further:

> "As a condition to further advances of loan funds or approval of a loan, borrowers whose general funds exceed the greater of $100,000 or eight percent of Total Telephone Plant (the 'appropriate general funds level') shall be required to use this excess to supplement loan funds for approved loan purposes, except as otherwise authorized by the Administrator of REA." (emphasis supplied)

By definition, "Loan Funds" means "the cash advanced to the borrower under loans made or guaranteed under the RE Act". Loan Funds are treated separately in the proposed rule and are excluded from the definition of "general funds":

> "General Funds means all cash and investments no held in trustee or similar accounts as required by loan contract or security instruments and normally includes the balances of (specified accounts)".

So, what we now have is the government moving to adopt a rule restricting the accumulation and use of a borrower's own funds in connection with a federal loan program based upon a perceived abuse over 20 years ago originating soley with the use of the government's loan funds. Mr. Chairman, if this hearing had been held back in 1984 it would have made George Orwell look like a prophet.

But, it is even more bizzare. Not only is government seeking to restrict the flow of loan funds based upon this arbitrary test of the accumulation or use of borrower funds, under the rule they would also seek to require the borrower to apply any of its own "excess" funds "to supplement loan funds for approved loan purposes" if they are ever again to draw down loan funds from REA.

Statutory Authority

Let's look at the Act to determine the authority for such a far reaching regulation. There is no reference in the proposal to a specific authorizing provision in the Act -- so there is no help there. In reviewing the Act, however, we find that the Administrator does not have the boilerplate rulemaking authority contained in many Congressional acts which would permit him to adopt whatever rules are necessary to carry out the purposes of the Act. But, that is not surprising since REA is a lending agency and not a regulatory agency and that is a provision normally associated with regulatory authority.

Unless it intends to proceed further and intrude into the everyday affairs of borrowers,all the agency needs to administer the Act is a well written loan contract. That conclusion is confirmed by Section 4 which, by authorizing in specific terms, limits the Administrator's discretion to attach conditions on loans to those expressed in the following proviso:

> "Such loans shall be on such terms and conditions relating to the expenditure of the moneys loaned and the security therefore as the Administrator shall determine ..."

On the other hand, the Act states in Section 305:

> "The Administrator is authorized to make insured loans under this title and at the interest rates hereinafter provided to the full extent of the assets available in the fund, subject only to limitations as to amounts authorized for loans and advances as may be from time to time imposed by the Congress of the United States for loans to be made in any one year ..." (emphasis supplied)

That the Administrator must make loans to all qualified applicants has been confirmed by the Courts (e.g. Sioux Valley Empire Electric Association, Inc. v. Earl L. Butz, U.S. Dist. Ct., Nov. 29, 1973, 367 Fed. Supp. 686, affirmed at 504 F. Rep. 2nd 168) which stated in interpreting the REA Act:

> "The Secretary has the nondiscretionery duty to make the loans to qualified applicants."

These references lead to the inescapable conclusion that the Administration simply does not have the requisite authority to adopt such a restriction on borrowers. That the Administrator may have reached a similar conclusion might explain why he has not finally acted on the proposal even though it has now been pending since August of 1983. I believe that out of all the comments received, none recommended adoption of the proposal.

REA has stated in the meantime that it will consider requests on a case-by-case basis as if the rule were final. This puts borrowers in a classic "Catch 22" situation. They are victimized by the rule as if it were in effect but may have difficulty in challenging it in the courts until final action occurs. This should not, however, preclude challenging the present policy as one inconsisent with provisions of the Rural Electrification Act, appropriation acts, loan contracts, and relevant court decisions.

Rationale is Wrong

There have been efforts made to justify the rule on the theory of protecting the government's loan security. But, a lender generally tries to enforce measures designed to enhance the borrower's financial status to protect his loan, and not the other way around, as this rule would require. The proposal would actually discourage borrowers from accumulating general funds and therefore making the government's security less attractive since the 8% represents a maximum rather than a minimum requirement. Also, the proposed rule is not drafted in keeping with "generally accepted accounting principles" since the calculation involves non-cash items and would treat assets which represent cash expended in prior years in the same way as cash in the bank.

The Administration, rather than relying on the original appropriation committee report language, has chosen instead to defend the proposal on the basis that it is necessary because many of the borrowrs are successful financially and should not be permitted access to low cost loan funds from REA. In other words, a regulatory device to ration credit to those systems deemed to be "worthy" in the eyes of the Administrator.

Mr. Chairman, there is no basis in the RE Act for such a proposition. What the Administrator is seeking is to amend the Act administratively without Congressional approval and adopt a threshold "means" or "needs" test. Congress specifically rejected such a concept in 1973 when the Act underwent its last major overhaul. And, Congress did it for a very good reason. The RE Act is not today, and never has been, a company welfare program. These borrowers are public utilities all of which are subject to ratemaking regulations under state law. As such, benefits from low cost REA financing are passed directly through to the subscribers in the form of better service and lower rates which is exactly what Congress intended. This is a program for people not companies. The companies are merely the vehicles which Congress employed to accomplish the Act's purposes. Telephone companies from the largest Bell operating companies down to the smallest telephone system are equally entitled to REA funds if they meet the Act's eligibility test for serving a rural area (1500 or less population) and are willing to accept the Act's obligations to serve the "widest practical number of users" in their entire service territory. This is a standard which REA vigorously enforces.

Conclusion

If a needs test is adopted it should be accomplished through the established Congressional processes for amending legislation -- not by administrative fiat. And, in my judgment, if Congress believes that such a test is needed, it should be based upon the costs of providing service in the territory being served not on the revenues or financial status of the company providing the service. That is the "need" that Congress was addressing when it passed the RE Act. And, the cost of providing that service is substantially greater today than it was in 1949. The more accurate basis for judging the continuing need for and value of this program is whether, as a matter of rational policy, rural America will continue to enjoy comparable telephone service at reasonably comparable rates with our urban society. This Committee, more than any other in the Congress because you have tracked the issue so carefully in the past two years, understands the needs for targeted assistance to high cost, rural telephone service areas. It also understands the terrific pressure which already exists on rural telephone rates and service caused by recent FCC and court actions. The REA program provides just such a mechanism for targeted assistance to rural areas. It is a loan program with a record of accomplishment unequalled in government and it is as needed today as it was in 1949.

But, if the program is to continue to accomplish its mission it must not be fettered with unreasonable or unnecessary borrowr restrictions or regulations. Many borrowers are already finding the current administration of the program too burdensome. An increasing number of borrowers are being precluded from receiving loans or from drawing down approved loan funds because of the general funds policy. Last year for the first time in history, REA failed significantly to meet the minimum telephone loan levels set by the Congress even though there was a substantial backlog of completed applications at the agency. At the same time, there is also a backlog of over $750 million in approved but unadvanced telephone loans.

The primary reason for these problems very simply is the restrictive REA general funds policy. There are adequate restrictions now in place to assure that loan funds go for their intended purposes. And, if there are abuses, then punish the abusers but not all rural telephone systems. So for none have been cited. I can only conclude that the Administrator is using this policy as a device to reduce loan levels in voliation of the intent of Congress.

The fact is that borrowers are not being permitted to do the job Congress intended because of an arbitrary administrative policy which the agency now proposes to make a binding regulation. It must be rescinded if Congressional objectives for the REA program are to be fulfilled for rural America. Otherwise, the annual loan levels set by Congress through the appropriations process are meaningless.

Thank you.

Mr. English. Thank you, gentlemen.

Gary, what would the elimination of REA standards mean to your system?

Mr. Kennedy. If you do not mind, I would like to kind of turn that around and say what the REA standards have meant, because I think that is the key.

It has meant adequate system design, uniformity of material for all borrowers, lower cost due to competitive bidding, quality material without cost penalties, proven products and acceptable designs that provide system facilities that would last and could easily be expanded to connect new subscribers, and enhancement of loan security in that facilities would last and not have to be replaced every few years.

I see the loss of a lot of those items.

Mr. English. What would be the impact on the subscriber rates?

Mr. Kennedy. I think that you would see that the subscribers' rates would have to be higher because of added maintenance and replacement costs, and also increased cost of material.

All that cost is passed right on to the subscribers so it would mean higher local service rates.

Mr. English. And what about quality of service?

Mr. Kennedy. I think quality of service will decrease if that takes place.

Mr. English. John, you heard my discussion at the very end with Mr. Hunter, with regard to some of the 5-percent funds and the use of those funds, and you certainly hit on that in your testimony.

Would you care to comment on the exchange we had back and forth about the use of the 5-percent loan funds to make money?

Mr. O'Neal. I certainly would, Mr. Chairman.

I imagine Mr. Vellone might have some comments as well. I think the Administrator was overlooking the distinction which should be made when REA loan funds are reimbursed to a borrower. As he stated, in many cases loan funds are reimbursed to borrowers who have already expended their own funds for approval loan purposes; and, of course, the thing that he was missing is that once the reimbursement takes place, the funds then belong to the borrower. They are the borrower's funds.

At that point, they are no longer Government loan funds. I hope that the Administrator was not suggesting that in the REA program abuses are occurring that have occurred in other Government programs such as the student loan fund, where the U.S. attorney here in Washington just recently announced that he intends to prosecute some of the recipients of those loans for misusing loan funds.

I submit that there are adequate protections in place now at REA—not only in the loan contract but in the other security documents as well, and in the agency's own policies to prevent that kind of abuse.

Borrowers are required to hold loan funds in separate trustee accounts, custodial accounts. To the extent that interest is earned on that money, it accrues to the benefit of the Government not the borrower. For many years, REA would not even permit a borrower to put loan funds in interest-bearing accounts.

In no case are they ever commingled with a borrower's own funds. If we do not accomplish anything else in this hearing this morning, I hope we clarify that confusion.

Loan funds from the Government have a totally separate character from the borrower's own money, and they are never commingled under REA policies. There are all kinds of restrictions in place to see that the loan funds go for those intended purposes.

To my knowledge no one has cited any specific examples of abuse, but, as you suggested, Mr. Chairman, if there are examples of abuse, those should be reported to the Justice Department. That is a criminal act.

But I heard USDA Under Secretary Frank Naylor make the same charge before the Agriculture Appropriations Subcommittee this year in the Department's testimony on REA loan levels. They seem to confuse the distinction between the borrower's money and the Government's money; and what this general fund's policy does—it only purports to regulate the use of a borrower's own funds, not loan funds.

And, as I mentioned in my testimony, by definition it specifically excludes loan funds from its operation.

What the Government is doing here is they are trying to tell the borrower what they should do and not do with their own money. We find that very objectionable, and, frankly, beyond the authority of the Administrator.

Mr. **English**. Do you think that Mr. Hunter just simply did not know what the situation is, what the law is, and what the requirements of his own department and agency are?

Mr. **O'Neal**. Well, Mr. Chairman, I am afraid I would have to defer to Mr. Hunter on that. I would not want to assume what his motives were.

But certainly the facts, as he was stating them, were erroneous.

Mr. **English**. Mr. Vellone, would you care to comment on that? You spent a lot of years down there with the REA and are familiar with all the laws, rules and regulations pertaining to this situation.

Mr. **Vellone**. Thank you.

Mr. **Kindness**. Mr. Chairman, would the gentleman who is about to testify identify himself for the record. He is not on the witness list.

Mr. **English**. I identified him, I believe, that Mr. Joe Vellone will accompany Mr. Kennedy.

Mr. **Kindness**. Sorry, I missed it.

Mr. **Vellone**. Yes, I am special counsel for the National Telephone Cooperative Association, and I am assisting Mr. Kennedy with questions and will respond to any questions you may ask of me, in the interest of getting information. More light than heat is what we need.

Mr. **Kindness**. Thank you for the identification, Mr. Vellone.

Mr. **Vellone**. Thank you.

I want to emphasize that the use of loan funds for a purpose other than authorized in the loan is a crime, and is—believe it or not—one of the few instances that has caused borrowers in the past to run afoul of the law, because there is such a thing as the false reports statute, and the requisition that borrowers submit to REA to get loan funds is a report of what they are going to do with the money that they are drawing down.

So, definitely, it is against the law for a borrower to get money for a loan purpose and use it for investment purposes.

On the other hand, as was made clear before, if a borrower spends its own money first for a loan purpose, it can then ask for reimbursement of those funds under the loan contract.

And once it gets that money, it is the borrower's own money to do with as it pleases. So they are two distinct things that can be kept in mind.

It was absolutely wrong for the Administrator to insinuate that the borrowers were mixing loan funds and general funds for investment purposes. I doubt very much that he will be able to establish that to be the truth in response to your questions.

There is a bulletin that REA has published that explains the circumstances in which the borrower may get interest temporarily on loan funds received ahead of time, or finds out after it has received them there is some delay in making the required payment.

It may obtain interest in those circumstances, but that interest is put in the trustee account, and is used to—is deducted from the amount of loan funds required to do the job, so the Government gains on the interest investment in those unusual cases.

That bulletin or that section of the bulletin on that subject should be put in the record.

[See app. 4.]

Mr. **English**. Thank you, Mr. Vellone.

Mr. Kindness.

Mr. **Kindness**. Thank you, Mr. Chairman.

Mr. Kennedy, since you did not feel that it was appropriate previously to respond to the chairman's question, I am going to ask you one more time to see whether you would have an answer to the question as to what you see as the effect upon borrowers—telephone borrowers—if the standards services were not provided by REA.

Do you see that they would immediately go out and buy cheap Japanese equipment, abandon present standards, hire people who are not capable of constructing facilities?

Would this have this immediate effect?

Mr. **Kennedy**. I think earlier this morning I heard you say that you had a couple of non-REA telephone companies in your area.

Mr. **Kindness**. Non-REA borrowers.

Mr. **Kennedy**. Not REA borrowers.

Mr. **Kindness**. At present.

Mr. **Kennedy**. Suppliers of digital equipment, and cable, use the specifications that REA has approved.

So, even though your companies in your area are not REA borrowers, they are still getting the benefit of the REA borrowers, engineering standardization.

Mr. **Kindness**. Would you care to answer the question?

Mr. **Kennedy**. Well——

Mr. **Kindness**. I do not understand.

What would be the effect if the standards were not supplied by the REA?

Mr. **Kennedy**. The problem that we see is, how do you enforce the standard, if you get different companies that have different standards? How are those standards enforced?

REA borrowers all use the same standards, but if you have somebody else setting standards that does not have loan authority, there can be several different standards, and you would not be following the same thing.

Mr. **Kindness**. If there was a problem—you see, I am trying to understand what the problem really is—is the problem that one noncomplying, let's say, noncomplying phone system would cause problems for other phone systems that interconnect with it—is that the kind of problem that we are dealing with?

Mr. **Kennedy**. Yes, you could have that.

Of course, the quality of an item that would be produced might not meet the standards that you would like on the other end. Take the example of Mr. Hunter's barn referred to this morning. You have this barn that is built, according to your own specifications.

If it is not built right, it only affects Mr. Hunter. I have got a barn on my farm not attached to anything. In the telephone industry, however, everything is connected through a network; and if one part of your network does not meet the standards, then it does affect other people.

Mr. **Kindness**. All right, now.

Now, is that the area of greatest concern—you know, as an interconnecting system, you would have problems, is that the principal thing?

Mr. **Kennedy**. Well, also, you have competitive bidding, where you have the same standards.

And I think if you do not have that, then you are going to have higher costs when you have bidding.

Mr. **Kindness**. So, it is a real value to the borrower to have this service, is it not?

Mr. **Kennedy**. I think it is, yes. I think it not only benefits us; it benefits other companies, other agencies, and other countries too.

Mr. **Kindness**. It would be difficult, I am sure, to put a dollar figure on that. But if the proposition were to be adopted by the Congress that a user fee—a percentage point, or half a percentage point on loan funds or something of that nature, whatever it might be that would be in a fair level, that would pay for the cost of that service to the REA, how would that affect REA borrowers?

Could you tell me whether that would be a burdensome problem?

That is, the saving by having the standards set by REA seems to be pretty well established. Would this not be a valuable service to keep even on a user fee basis?

Mr. **Kennedy**. I think it needs to be kept. The only thing that I am concerned about is fewer and fewer companies are eligible now for REA borrowing and the companies that remain eligible are more needy; is it right to pass that cost on them? Those companies that really need REA most are going to have to raise subscriber rates.

Mr. **Kindness**. So, you have a declining population of borrowers under present conditions, and that means the cost per borrower would have to be higher to offset the total then?

Mr. **Kennedy**. Well, with the 8-percent level, there are fewer and fewer companies that are eligible to borrow from REA, under its policies.

Mr. **Kindness**. So, there are less and less companies that are being guided by these standards——

Mr. **Kennedy**. Well, all REA borrowers, past and present, operate under those standards.

Mr. **Kindness**. So those standards are updated from time to time more or less constantly, is that right?

Mr. **Kennedy**. Yes.

We continue to use those standards, although at the present time the 80-percent general funds limitation prevents us from drawing advances on loan funds already approved by REA or obtaining new REA loans. We continue to use REA standards, and review the advisory bulletins that REA's Standards Division publishes.

Mr. **Kindness**. Mr. Kennedy, we have a statement from Representative James Courter of New Jersey, which came in this morning, and has been incorporated in the record, which indicates that Bell Communications Research, which already does much of the highly technical and innovative standard work for seven regional Bell operating companies, would be interested in looking into the performance of that standard setting work applicable to the rural telephone companies that deal with REA borrowing.

That does not tell us very much about what the terms would be, or what their effectiveness could be in this area and so on; but would you have any response to that kind of an idea of such a service being provided in the private sector, realizing that they would not have any enforcement authority?

Mr. **Kennedy**. Well, an organization which serves large telephone companies is going to be primarily interested in promoting the interest of those large companies, which depends on revenue generated in a densely populated area not served by the small rural telcos, and I do not think they would have the interest in the rural areas as the REA standard divisions do.

Mr. **Kindness**. Well, I thought the question here was not so much an interest in rural areas as in good telephone services.

Is there a conflict there?

Mr. **Kennedy**. What was the question again, sir?

Mr. **Kindness**. I say, I thought the question was not so much an interest in rural areas as in the providing of good telephone facilities and service. Is there a conflict between those two?

Mr. **Kennedy**. No, we are interested in providing good service in rural areas.

Mr. **Kindness**. In other words, I thought we were dealing with standards having to do with technical matters—what kind of equipment is good to have, and what kind of structure is good to construct, and that sort of thing, which needs to be adaptable to rural telephone systems circumstances.

I just do not quite understand the response that some firms dealing with this kind of service to—and they are in the research and laboratory kind of work, that they would be looking at anything other than the type of equipment and facilities that would be specified.

I do not understand where the conflict comes in exactly. Is there likely to be a conflict?

Mr. KENNEDY. In rural areas, we might have to go out 30 miles, or 40 miles from an office to connect a subscriber. There are very few larger companies that go out that distance; and to get that signal out to the end takes a certain type of equipment that has been designed by the REA Engineering Standard Division—and it works.

I do not see where that the Bell Co. would be building engineering equipment for that specification.

Mr. KINDNESS. For example, would you—I am trying to see whether we are dealing with fact or emotions here.

Would you believe that Bellcore, or Bell Communications Research, or whatever it is, which deals in this area of research and development would be less qualified than the REA personnel to deal with this subject matter?

Mr. ENGLISH. Would the gentleman yield?

Mr. KINDNESS. Surely.

Mr. ENGLISH. We have received a copy of a position statement from the people at Bell Communications Research, and without objection, I think it might be helpful if we entered this into the record. This is their position statement.

Their item No. 5, if the gentlemen will note, is that they recommend that work for rural telephone companies might most appropriately be sponsored and supported by an association or coalition of benefiting clients, which I think might be of interest since it does come from Bellcore itself.

Mr. KINDNESS. Could the record show that the chairman is referring to a piece of paper without letterhead or identification, but attached to which is a card——

Mr. ENGLISH. From the representatives of Bell Communications Research, and it is also identified with the date, April 17, 1985, and the name, and F. T. Andrews, Jr., being the author.

Mr. KINDNESS. And the card is that of Aubrey Sarvis of Bell Communications Research——

Mr. ENGLISH. Here in Washington.

Mr. KINDNESS. That is correct.

Mr. Chairman, I do not know what to say about the thing. Could we understand for the record where it came from, how it got——

Mr. ENGLISH. Well, it was just delivered here, as it was pointed out. It was delivered here today. We had asked Bellcore for their position, and so they just provided it to us.

Mr. KINDNESS. Well, Mr. Chairman, I have no objection to putting it in the record. I do not have a copy of it or anything, but——

Mr. ENGLISH. Well, we will make sure that you have a copy made available to you.

Mr. KINDNESS. Thank you, Mr. Chairman.

[The text of the position paper follows:]

Position statement on potential transfer of REA's engineering standards function to Bellcore.

(1) REA has explored the relationship of present engineering standards work to Bellcore's work program.

(2) This work is technically similar to Bellcore's generic requirements work for its owners, but oriented to the needs of rural telephone companies.

(3) Were Bellcore to undertake this additional work it would be in furtherance of exchange and exchange access activities but for a broader base of telephone companies.

(4) Bellcore is now exploring the possibility of making these services available to all exchange telephone companies in the interest of a more standard national network.

(5) Work for rural telephone companies might most appropriately be sponsored and supported by an association or coalition of the benefiting clients.

Mr. **Kindness**. My question still is perhaps on a more general basis applicable though.

Is there any reason we ought to be aware of before further proceeding with this issue that the private sector could not provide these services?

I mean that we have heard the arguments about nobody cares as much as the folks who are doing it at REA.

I understand that, but they may not be the only ones who could provide that service.

Is the essential difference just the enforcement capability?

Mr. **Kennedy**. I would like to ask Joe Vellone to answer that question for you.

Mr. **Vellone**. I would be happy to, if I may.

These are a number of related problems. An independent organization, of course, can be hired to do almost anything that anybody wants to have done. The basic questions develop as to what are the costs, who benefits therefrom, and how effective will they be?

Now, you have already pointed out that one of the problems with a voluntary standards group is that it cannot enforce the standards; but one of the things that keeps cropping up here is the cost and the possibility of a user fee.

And the important thing is that the primary beneficiary of the present standards function, believe it or not, is the U.S. Government itself—not only the REA but the military establishments and the Department of Commerce, which makes use of these standards in promoting foreign trade. The Defense Department uses these standards because so many military establishments are in rural areas, especially the missile silos necessary for national defense.

They are in the service areas of these small telephone cooperatives and companies and the military cannot get the proper standards from the Bell System because theirs are not designed for the specialized problems of rural areas.

But as far as the costs are concerned, and the savings involved, the U.S. Government and REA save considerable sums of money through these standards.

We keep talking about this being a service for the borrowers. It is a function or responsibility of REA itself, in the interest of loan security. REA must have real insight to make sure that junk is not put on the system, because if it is junk it has to either be repaired frequently or replaced shortly, requiring additional loan funds.

The executive vice president of the Power and Communications Contractors Association has established, and I think he quoted the figure of an average savings of $133 million annually, savings many times greater than the small amount of administration costs, resulting from the fact that these standards are part of an entire process of establishing contracts to be used in competitive bidding.

These small and rural systems which do not have many engineers on their staffs to develop standards—in fact, most of them do not have any engineers do have the advantage of being able to request competitive bids and know they are going to get bids on whatever they are asking for, and not something else, because there are units of construction that depend on these standards, and the standards themselves reduce the cost of material because anybody can provide these materials, not just big companies.

Small companies in rural areas can provide items that satisfy the requirements of REA, and because of their peculiar situations, they may be able to outbid, say, General Electric and the bigger corporations.

Mr. **Kindness.** Mr. Vellone, I take it that your answer is yes and no—that is, that there are both aspects to this—that is, the lack of enforcement authority——

Mr. **Vellone.** Yes.

Mr. **Kindness** [continuing]. Would be a problem. But that there is also a capability within the REA staff that really would not be duplicated elsewhere.

Mr. **Vellone.** That is right. There is a specialty in the REA staff that can be found nowhere else because it has been concentrating on rural telephone facilities and services from the beginning.

Mr. **Kindness.** Yes, I understand why.

Now, let me ask you this: Is it then your opinion that there is more value that is attributable to the benefit of the taxpayers generally—the REA is the lender and so on, than there is to the borrower.

That is, the borrower benefits, too, I take it?

Mr. **Vellone.** The borrower benefits, but REA benefits too, because, in the first place, this process results in much smaller loans than would otherwise be the case—without competitive bidding, without the ability of many manufacturers to compete to provide quality materials at low cost—and, also, and this is very important too, because the amount of engineering professionals that REA would need would increase rather than decrease with the abolition of standards, as it would take them that much more time to make sure that the work under the contracts is being done right; and that the proper materials are being used under standardized contracts.

All this is simplified, and REA is able to operate with fewer engineers than life would be able to operate without the standard function.

Mr. **Kindness.** That would—I think I get the impression that you would not be in favor of a user fee, but is the service valuable enough that—it has been brought to light through this hearing, I guess, principally, that when there was discussion of possibly doing away with it, that there was a great deal of value associated with it, and that brings up the question of is it appropriate then that there be a user fee.

I guess there would not have to be a user fee of very much in order to really still be very small in relation to the real value of this service.

Mr. VELLONE. Well——

Mr. KINDNESS. I guess it has got the spotlight all of a sudden because of the argumentation in this thing.

Mr. VELLONE. Yes.

As far as a user fee is concerned, first, I might say that many of these telephone systems, with their current problems, as a result of divestiture, do not need one more burden for them to carry.

But, more important than that is the fact——

Mr. KINDNESS. And neither do the taxpayers, and that is what——

Mr. VELLONE. Well, the taxpayers are being helped by a continuation of standards.

Mr. KINDNESS OK, well, I do not understand the relative dollars involved here in relation to the total budget—and it is very small, but I think I can understand a little bit better where the arguments have come, and where they are leaving on this thing now.

Mr. O'NEAL. Could I comment on that, Mr. Kindness?

As a matter of principle, I do not disagree with user fees. But, normally user fees are associated with services that are provided by the Government to a selected group of beneficiaries such as campers in national parks. That is one thing that springs to mind where individuals are getting a specialized benefit from the Government. Frankly, I submit that that is not the case here.

If, only as a last resort, as you have posed it, we were able to retain the standards function at REA through a user fee, then I supposed we would all agree to it, but I really do not think that the logic is applicable here.

As Joe has very well pointed out, under a user fee concept the principal beneficiary of the standards function is the Government of the United States. Not only because of the use of these facilities by the military establishment, but also through competitive bidding practices which conserves loan funds. It also protects the security interest of the Government which REA is vitally concerned about. As a secondary class, the beneficiaries are not only the 13 million people in rural America who receive REA telephone service, but everyone in the Nation as a whole, because every time a telephone is hooked up in this country, it benefits everyone else that has one.

Mr. KINDNESS. Yes. Well, obviously, we could say the same thing about the standards that are set in the private sector for the 90 percent of telephone service in the country; and that is—you know, not done at taxpayer expense.

So, it is either paid for by the consumer or the taxpayer someplace anyway. I am just trying to determine whether it is a reasonable middle ground here to look at.

Mr. O'Neal, if I might ask, with regard to your testimony, on page 2 you referred to the—you said:

"The subcommittee should note that the House Government Operations Committee, in another matter involving REA administrative actions, determined"—and so on.

Could you identify that "other matter," please?

Mr. O'NEAL. Yes, sir. It was a matter involving another bulletin of REA, which sought to restrict individual political activities of borrowers and their members. I think I cited the reference to the report in my written testimony.

Mr. KINDNESS. Right.

Mr. O'NEAL. That was another Administrator and another time, but I think the logic is equally applicable.

Mr. KINDNESS. I was wondering what applicability would that have to this current situation.

Mr. O'NEAL. Well——

Mr. KINDNESS. The report says—and we know how these reports of the Government Operations Committee are written, by the way.

It says that "The Administrator has no authority to enforce either Federal or State criminal laws," which, of course, we all know without stating it; and statements that are gratuitous like that appear in reports of this and other committees of the Congress all the time.

Sometimes it is because the minority does not fight hard enough about the particular wording that goes into reports, and then we have it cited back to us like this.

It has no meaning whatsoever; and you are citing it as authority for some proposition. We fight that all the time in this committee.

So, I do not believe that your statement here has helped your case very much at all.

Mr. O'NEAL. Well, except to say, Mr. Kindness, that the rationale of this report is supported by court decisions, and I cite them as well.

Mr. KINDNESS. The rationale of the statement that the Administrator has no authority to enforce Federal or State criminal laws, for example?

Mr. O'NEAL. Yes, sir. I think there is ample——

Mr. KINDNESS. It does not take a court decision to know that, does it?

Mr. O'NEAL. No, it does not.

Mr. KINDNESS. I really do not understand why you cited that, but it certainly detracts from your argument, at any rate.

Mr. O'NEAL. Well, the reason—if I may respond—is that I wanted the committee to be aware that there had been past situations considered by this committee where the REA Administrator had taken actions which when reviewed were determined to be beyond his statutory authority, and that is the only purpose for which it is cited here. Certainly it is not intended for any purpose other than that.

Mr. KINDNESS. Well——

Mr. O'NEAL. I was not connected with that hearing in any way.

Mr. KINDNESS. I would certainly like the record to show that I do not believe that it supports your argument in this case at all, and it is just not authoritative in any respect, plus it has to do with an unrelated matter, which if you were making the point that the Administrator does not have the authority to do what he is proposing to do—in this case, that is fine; your argument is better than that committee report citation, I am afraid.

Mr. O'NEAL. Thank you, sir.

Mr. KINDNESS. I would like to ask whether copies are available of the comments to which you refer on page 3 of your testimony—the comments of your association submitted on August 23, 1983 opposing the rule, and asking that the policy be rescinded. Those were not attached to your testimony, were they?

Mr. O'NEAL. No, they were not, but I did ask that they be included in the record of the hearing.

I do have an additional copy here. I will be glad to furnish you—I thought it had already been furnished to the committee staff.

Mr. KINDNESS. I appreciate that.

Mr. Chairman, I may have exceeded my 5 minutes.

Mr. ENGLISH. Go ahead, I have a few more questions; you go ahead and finish whatever questions you might have.

Mr. KINDNESS. Mr. O'Neal, I want to touch on this subject again of "needed services," which was referred to earlier when Mr. Hunter was testifying.

Do you know of any definition of needed services that is generally accepted, or appears any place in regulations or guidelines of REA?

Mr. O'NEAL. No, sir; I do not. Frankly I was kind of perplexed by the question earlier because I really do not know to what it refers. Certainly there is no accepted legal definition of what constitutes a "needed service" in my judgment.

Mr. KINDNESS. Well, I guess it was the attachment to the testimony of Mr. Kennedy, a statement of the National Telephone Cooperative Association, which was attached—that is the comments of the National Telephone Cooperative Association submitted to the REA with respect to this proposed rule that gets into the "needed services" arguments, generally.

And so perhaps——

Mr. VELLONE. Yes, may I answer? I am one of the authors of the comment, and what we are referring to here has nothing to do with loan funds but the use of the borrower's general funds to provide additional services which the borrower thinks is necessary for his community; and we are not mixing up loan funds and general funds in this case.

As has been brought out in Mr. O'Neal's testimony, general funds are not Government funds any more; they are the borrower's funds, developed through rates over time, which are part of the assets of the corporation. This borrower is a corporation that is not a government entity. It should have considerable management discretion as to what it does with this money.

And if it wants to provide services in its service area, it should not have to be handicapped in doing so when other public utilities are able to diversify their services; so the question of what is "needed services," depends on the particular locality and the particular company involved.

It is not a legal term at all.

Mr. KINDNESS. But the question would not arise at all, I suppose, unless Government funds were being loaned at 5-percent interest rate.

If the rate of interest involved was the market rate, or the rate at which the United States is borrowing funds to supply those loans, then this question would just disappear, would it not?

Mr. VELLONE. Not necessarily. What we have here is the fact that this is a private entity, and there is nothing in the Rural Electrification Act or in the loan contract itself, that prevents a borrower from using its general funds, say, to even build a television plant—cable television plant—as part of the facilities of the local telephone company.

The borrower can do that. What we object is that sometime in the future the REA will say, "Well, you have put money—your own money, it may be—but nevertheless, you have put money in your cable plant, and therefore we are going to deny you loan funds."

There can be situations where the amount of funds invested, say, in things that are not cash, which are not prohibited by the contract, by law or anything else may very well exceed 8 percent of the amount of telephone plant. The investment is not prohibited when made; but retroactively at some later date. Let's put it another way: You can have a brand new telephone company applicant come to REA for loan funds, and it already has an amount equal to 10 percent of its telephone plant in cable television facilities. It is automatically denied an opportunity to get an REA loan, which it is entitled to under the law, because it owns cable television facilities.

That borrower meets the eligibility requirements in the law, but it does not meet the eligibility requirements of an administrative bulletin that has a questionable legal basis.

Mr. **Kindness**. Do I understand correctly that you view the currently proposed change in that practice or guideline, or rule, or whatever it is as being more restrictive than what it was before August of 1983 or whenever this rulemaking proceeding started?

Mr. **English**. June of 1983.

Mr. **Kindness**. More restrictive?

Mr. **Vellone**. It is more restrictive because it will be issued in the form of a regulation. The present bulletin is nothing more than a guideline; it is not a regulation.

Mr. **Kindness**. And as to the way that it is applied, is that more restrictive or less restrictive?

Mr. Hunter testified earlier that for telephone companies, it was less restrictive. Do you differ with that interpretation?

Mr. **Vellone**. It would be more restrictive in that there would be fewer opportunities for the Administrator to exercise judgment, and give a waiver in various cases, once it is a regulation.

As a guideline, he makes exemptions all the time, when he wants to with respect to general funds.

Mr. **Kindness**. But the measurement that is applied, is it not less restrictive than the practice prior to this proposed rule?

Mr. **Vellone**. Let's put it this way: He claims it is very generous, but when you analyze it, he is going to allow the borrowers to do what they could do anyway.

If they can pay dividends without REA approval, they can invest the same amount in a subsidiary. He just makes it sound like it is more favorable, but, as a matter of fact, it is a tighter noose around the management of these rural systems, because the Administrator is going to prevent himself any discretion with regard to a rule that has become a fixed regulation with the force of law. The present bulletin does not have the force of law, and we doubt that it would survive a court challenge.

Mr. **Kindness**. Now, the proposed regulation does allow the discretion of the Administrator to otherwise authorize the use of general funds. This is expressed in the final words of that sentence on the top of page 4 of Mr. O'Neal's testimony, I guess, where it says that:

> The borrower shall be required to use this excess to supplement loan funds for approved loan purposes except as otherwise authorized by the Administrator of REA.

And you feel that that language is not sufficient to preserve the flexibility that existed prior to this proposed rule, is that correct?

Mr. **Vellone**. There is 100-percent flexibility in the present rule; there is not in the proposed regulation. I am sorry, I meant "bulletin," not rule because the bulletin is only a policy guideline.

The word "may" appears all through the present policy bulletin but does not appear in the proposed regulation.

Mr. **O'Neal**. While the proposed rule would appear to give the Administrator unlimited discretion, of course, as a regulation, it would have to be uniformly enforced, and he would have to justify his actions. He could not discriminate between one borrower against another. There would be a number of restrictions on his ability to waive those requirements. As a practical matter, he has not been willing to waive those requirements under the policy either.

I was glad that the request was made for the record here today to document those cases where the administration has granted such discretionary exclusions from general funds.

Mr. **Kindness**. You see, I am confronted with this conflict. In most cases, or maybe, at least a great many cases, what those who have to deal with governmental agencies are looking for is some regularity about things and not to have to go by the "hip-pocket rulebook," about which you have difficulty finding out how it is going to be applied.

And the whole purpose of our administrative rulemaking procedure—informal rulemaking proceedings—and the Federal record and all of that is to make sure that you do not have to deal with an agency on the basis of what the guy has got in his hip pocket.

Mr. **O'Neal**. I wholeheartedly agree with you.

Mr. **Kindness**. There is no way.

Mr. **O'Neal**. I wholeheartedly agree with you, Mr. Kindness, and if I have left you with the impression that I support a "hip-pocket" rulebook, I am sorry. We find the policy and the proposed regulation equally objectionable. However, it is a quantum leap we feel, from a guideline to a legally binding regulation.

That's the point we are trying to make. In our comments, you will see that when the proposed rule was proposed back in June of 1983, we asked that the policy be rescinded. We think that there is no basis under the act for the policy or the regulation; but we find it much more onerous as a regulation because we believe if it is not objected to now, before its adoption, it will have to be uniformly enforced across the board.

Does that clarify the confusion?

Mr. **Kindness**. It does. Thank you very much.

Thank you, Mr. Chairman.

Mr. English. Thank you, Mr. Kindness.

There are a couple of points that I would like to touch on, particularly on the question of user fees.

On page 31 of the draft report made to Mr. Hunter—it states the findings of a study that was done. They determined that other groups have benefited from standards, not just the cooperatives and their customers. Specifically, they were pointing to the Agency for International Development, the State Department and the National Communications System of the Defense Department.

So, I assume if we are going to go after a user fee, that would have to apply also to those agencies of the U.S. Government that benefit from the standards, as was found by the Government's research team here.

Again, I think that it is important since, at least, it is my understanding that the REA's thoughts were that Bellcore was the entity that should take over this responsibility. However, Bellcore has made the point—and I think it bears underscoring again—that rural telephone companies might more appropriately be sponsored and supported by an association or coalition of benefiting clients, which sounds to me like the REA, particularly whenever you take in the enforcement aspect of it.

I really have no further questions of our witnesses.

Mr. Kindness, would you like to make a comment, or thought?

Mr. Kindness. Mr. Chairman, on the point that you made previously, I would like to understand better what may be involved there.

The draft report says that "The project team determined that other groups also benefit from the presence of standards for rural telephone and electric systems. Specifically, the Agency for International Development, the State Department, and the National Communications System in the Defense Department indicated reliance on REA standards."

Those standards may not be subject to the kind of treatment I am thinking about, but other industry standards are frequently available in a book or code form and are sold; and, indeed, that is part of what occurred to me in this process that perhaps there are manuals that are distributed in some manner, and somebody pays for that and the taxpayers pay for it somewhere along the way.

And is it appropriate that such publications—now we are going to differ, I think on whether it is appropriate—but is there anything that you can cite to me as a darn good reason why those volumes could not be sold?

Mr. Vellone. For the record, it should be noted that many of the publications related to standards issued by REA are paid for by the borrowers themselves.

There is a standard engineering construction contract that is paid for by the borrowers. It has come to my attention that the list of materials acceptable for REA systems is a contract item; it is by subscription. It is updated every 2 months. It is supposed to be updated every 2 months.

Mr. Kindness. Have you got user fees?

Mr. Vellone. We have certain user fees right now which cover all of these particular items that are salable to whoever wants to get them.

Mr. **Kindness**. Now, what happens to the revenues coming in from those sources?

Mr. **Vellone**. They go directly into the Treasury, and are not used by REA.

Mr. **Kindness**. Now, is there a way of accounting for those funds?

You know, maybe this thing is paying for itself? We do not know.

Mr. **Vellone**. It really is paying for itself in reduced costs—reduced loan funds, and reduced needs for other engineers in the standards function.

Mr. **Kindness**. I mean besides that, maybe a substantial part of the cost of that staff in the REA is already being accounted for by these revenues that do not go to pay their cost but go into the general treasury.

I would be most interested in any figures that we could come up with on that. We may be talking about a thimbleful versus two half thimblesful.

Mr. **Vellone**. That is right.

Mr. **English**. Well, I'm—have the gentlemen finished?

I would make another point, too. I think under the circumstances we need to check and find out whether these other departments and agencies of the United States Government—namely, the State Department, the Department of Defense, AID, and all these other folks, whether they are kicking in their share?

Mr. **Vellone**. I will bet they are not.

Mr. **English**. I will bet they are not either. So, I think what the Administrator needs to do is to get on his high horse and get over there and see the Secretary of Defense and the Secretary of State, and get his hand out and say, "We want our money."

I bet you this will be a moneymaker before this thing is over.

Mr. **Kindness**. Well, it sounded like it had all the potential.

Mr. **English**. I believe you may be right, and I believe the Administrator is about to give away a moneymaker right here in the Government. So, I think that that may be a good point, and this may be a good note to end this whole proceeding.

Mr. **Vellone**. I hope to see some bids.

Mr. **English**. All right.

I thank all of our witnesses for their cooperation. I appreciate it.

Mr. **O'Neal**. Thank you.

Mr. **English**. With no further comment, then, we will recess, subject to the call of the Chair.

[Whereupon, at 12:42 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

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APPENDIXES

APPENDIX 1.—STATEMENT OF UNITED STATES TELEPHONE ASSOCIATION CONCERNING REA TELEPHONE STANDARDS AND REA TELEPHONE GENERAL FUNDS POLICY, APRIL 18, 1985

STATEMENT OF
UNITED STATES TELEPHONE ASSOCIATION
SUBMITTED TO THE
HOUSE
SUBCOMMITTEE ON GOVERNMENT INFORMATION, JUSTICE AND AGRICULTURE
COMMITTEE ON GOVERNMENT OPERATIONS
CONCERNING
REA TELEPHONE STANDARDS AND REA TELEPHONE GENERAL FUNDS POLICY
APRIL 18, 1985

OPENING REMARKS

The United States Telephone Association (USTA) is the nation's largest exchange carrier trade group, representing 1100 member companies which includes the Bell operating companies and Independent phone companies. Together, USTA members provide over 99% of all access lines. Diversity is a trademark of the industry. Firms range from publicly-held corporations listed on the New York Stock Exchange to family-owned rural companies. And there are more than 250 cooperatives owned by their customers. The traditional Independents serve 59 percent of the nation's "telephone territory" and the Bell companies serve the rest.

The nation's local telephone companies are dedicated to two things - serving the nations telecommunications needs and maintaining universal service. USTA members, large and small, firmly believe that in order to maintain a healthy and growing rural telephone industry, that provides universal telephone service, a strong and viable Rural Electrification Administration (REA) is needed. Two key REA issues in obtaining these goals are the continuation of REA Technical Standards and a reexamination of REA's General Funds Policy.

RECOMMENDATIONS

The United States Telephone Association (USTA) recommends the following for the REA Telephone Program:

- Retention of the REA standards function and the Telephone Engineering and Standards staff as they are beneficial to the rural telephone industry. REA Standards are a mix of equipment specifications, competitive bidding requirements, and standard contracts. Discontinuing any or all the mix would not be in the best interest of REA borrowers or REA.

- REA should not impose restrictions or regulations on REA borrowers own general funds. There are already effective regulations in place which assure that REA loan funds are used exclusively for purposes in the Rural Electrification Act.

REA STANDARDS

The REA standards are a part of a rural engineering philosophy developed by REA over the years. The engineering functions associated with standards can be divided into two major areas:

Standards

- Performance Specifications
- Design Specifications
- Test Specifications
- Manufacturer Quality Assurance

Other Functions Which Are Not Actual Standards

- Standard Contracts
- Standards Construction Units
- Competitive Bidding
- Construction Guides
- List of Acceptable Materials
- Field Trial Evaluations

Standards themselves can be further subdivided between potential consensus standards applicable to the entire Telephone Industry and non-consensus standards applicable only to REA or rural telephone companies.

One important point is that, Standards and the associated rural engineering philosophy developed by REA, are embedded in the whole REA program from making a loan to approving construction. The following is an brief overview of this process:

1. Writing and Setting Standards: REA sets standards with Industry participation. Often REA adopts industry equipment specifications.

2. Field Trials: REA requires a field trial for new equipment and makes decision on acceptability.

3. Pre-Loan Engineering Design Prepared by Consulting Engineer and Submitted to REA: REA approves all engineering designs for to ensure that standards and specifications are met and reflect reasonable projected costs.

4. Post-Loan Requirements: REA requires the use of competitive bidding, standard contracts, standard construction units and construction guides. These requirements are contained in the same bulletins that include equipment standards.

5. Certification of Installation: A Registered Engineer is required for self certification; however, the majority of plant installation is certified by REA itself.

If REA is seeking to change its total engineering philosophy and eliminate standards, then the changes will be massive for both REA and the Industry. The majority of REA rules and bulletins now refer to or depend on REA standards. The rewriting of these rules and bulletins would be extremely extensive and time consuming for REA. The industry would be burdened with maintaining standards with possibly little power to enforce them. Furthermore, the lack of standards has the potential to increase costs for over 1000 telephone companies and millions of telephone subscribers.

REA standards continue to have the following benefits to REA borrowers:

1. Assures quality equipment and construction of telephone plant.

2. Reduces equipment costs by providing a standard for mass production.

3. Reduces construction costs by developing Standard construction units.

4. Protects small rural companies through the competitive bidding process and standard contracts with manufacturers.

5. Requires field trials of new equipment and publishes lists of acceptable materials.

Certainly, REA standards are viewed by the industry as a benefit, not as a burden. Furthermore, USTA's analysis concludes that by eliminating the REA standards function, small companies and cooperatives would be particularly disadvantaged. While larger companies have more in-house engineering expertise, smaller systems need REA assistance more now than before because of rapidly changing technology and increasing competition.

The Industry believes that the logical place for rural telephone Standards is at REA.

GENERAL FUNDS

General funds and REA loan funds are entirely different sources of capital. REA loan funds are borrowed from REA for the specific purpose of constructing telephone plant. REA has rules in place which require borrowers to submit detailed plans including engineering designs on the use of loans funds. These regulations ensure that REA loan funds actually are to be spent for the stated uses.

On the other hand, general funds are the resulting cash flow generated from telephone company provided services. This money is owned by the REA borrowers themselves; however, REA has very restrictive policies on how REA borrowers may use this money.

If rural consumers are to benefit from "The Information Age" and competition in the telephone industry, then telephone companies must be permitted, even encouraged, to diversify their operations to include other telecommunications services. The restrictive administrative policies of the present Administrations are the most significant deterrent to the successful diversification of REA Telephone borrowers. Since REA has a lien on all property of the borrowers (whether now owned or hereafter acquired) diversification cannot occur without the cooperation and approval of REA.

The present REA general funds policy determines advances for approved loans that can be drawn down by REA Telephone borrowers. If general funds exceed 8% of telephone plant or $100,000 whichever is greater, then REA funds cannot be advanced. The REA borrower must use his own general funds to construct telephone plant. There are certain exclusions on a case by case basis, from this 8% rule but the exclusions are limited to investments under REA act purposes which are generally rural exchange telephone services.

Investments in related telecommunications projects such as CATV, Satellite antennas and possibly cellular radio even though not liquid are considered general funds in many instances and not excludable from the calculation. The effect of the REA policy is to limit borrower diversification and to limit provision of new services in rural areas.

Recently, it appears that REA is attempting to go further and to use its general fund policy to limit of loan funds even for rural telephone purposes. For electric loans, REA is working on a new policy that essentially would change the 8% rule to a 5% rule. If this also became a rule for telephone borrowers, the vast majority of telephone borrowers would be excluded from drawing down any funds in the future.

By law REA is required to make a finding that there is reasonable assurance the the loan will be repaid. Therefore, REA should encourage borrowers to diversify their operations to preserve loan security through the obtaining of the revenues needed to replace expected reductions in toll revenues and equipment rentals. In addition, REA policy should require a minimum level of general funds for loan security purposes. This would ensure a reasonable level of liquidity. However, REA's policies do just the opposite and encourage REA borrowers to keep their liquid assets at low levels.

The limits on REA loan funds is a function for Congress to decide. REA is responsible for making loans to REA borrowers in accordance with the purposes of Rural Electification Act and within the loan limits authorized by Congress. REA should not impose another policy to limit loans which at the same time severely restricts the borrowers ability to diversify into other communications related services. Therefore, the restrictions or general funds should not be retained.

APPENDIX 2.—MARCH 6, 1985, DRAFT COPY OF STUDY OF ENGINEERING STANDARDS FUNCTIONS PREPARED FOR RURAL ELECTRIFICATION ADMINISTRATION

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STUDY OF ENGINEERING STANDARDS FUNCTIONS

Prepared for:

Administrator,

Rural Electrification Administration

Prepared by:

Larry Sevier

Craig Wulf

Tom Nusbaum

Bob Lozier

March 6, 1985

Study of Engineering Standards Functions

Executive Summary

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Objectives - To examine all aspects of REA's technical standards-setting program as it now functions, and to make two determinations:

1. Whether a need for standards-setting exists in the rural electric and telecommunications programs.
2. If there is a need, whether the responsibility should more properly rest with the public sector or the private sector.

Scope - The scope was limited to the review of the need for engineering standards functions and where these functions should more properly be performed in accordance with present REA objectives and policies. The study did not include review or evaluation of the effectiveness and efficiency of ESD or TESD.

Methodology - Data was gathered through interviews (in-person and telephone), written survey forms and collection of existing papers and publications. The project team contacted 79 REA employees and 94 organizations outside REA.

Standards Definition - The standards-setting functions are divided into four areas:

1. List of Acceptable Materials
2. Standard Construction Drawings and Specifications
3. Standard Contract Forms
4. Standard Bidding Procedures

Is there a need for standards?

Benefits of Standards to REA - The following significant benefits of standards to REA were identified:

- Enhances loan security and provides a framework for increased financial viability to enable borrowers to obtain additional funding from sources other than REA.

- Facilitates determinations that loan amounts are limited to the lowest level possible that still enables accomplishment of program objectives; thereby, minimizing the possibility for waste and abuse of Government funds.

- Enables staffing requirements to be kept at a minimum level while maintaining the productivity and efficiency to meet the requirements set forth in existing policies and procedures.

- Allows program employees, non-engineers and engineers alike who do not have construction and design experience, to carry out their program responsibilities.

There were numerous significant benefits to other groups that are identified in the study. While these directly benefit other groups, they also benefit

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REA as they facilitate accomplishment of REA's program objectives - to enable its borrowers to provide reliable and dependable electric and telephone service at affordable rates and to protect loan security.

Conclusion - The benefits of engineering standards to REA in accomplishing present program objectives and policies overwhelmingly outweigh non-benefits. A need for engineering standards-setting exists in the rural electric and telecommunications programs.

Who should set standards?

Public Sector or Private Sector - In considering whether the responsibility for engineering standards-setting should more properly be performed in the public sector or the private sector, the project team believes that primary importance must be focused on REA being able to take full advantage of the benefits provided by engineering standards in accomplishing the stated program objectives of:

- Adequate and dependable electric and telephone services at reasonable rates in rural areas

- Protection of loan security

Public Sector Alternatives Considered

- REA
- Other Agencies

Private Sector Alternatives Considered

- Borrowers, Statewides, Regional organizations
- Lenders
- Trade associations
- Contracted organizations
- Standards-setting organizations
- New organizations

Strengths of REA Performing Standards Functions

- Ability to control standards
- Timeliness of setting standards
- Independence in setting standards
- Established reputation
- Ability to delist a product
- Motivation for developing standards
- Expertise
- Ease of field trial

Weaknesses of REA performing standards functions

- Continued borrower reliance on REA
- Discourages development of standards-setting expertise in the private sector

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Strengths of Private Sector Organization Performing Standards Functions

- Reduced borrower reliance on REA
- Encourages development of standards-setting expertise in the private sector
- Wider range of viewpoints

Weaknesses of Private Sector Organization Performing Standards Functions

- Lack of ability to control standards by REA
- No cost savings for REA
- Funding problems
- Problems with listing and delisting manufacturers
- Lack of timeliness of setting standards
- Uncertain motivation for developing cost saving standards
- Potential conflicts of interest

Recommendation - Based upon our evaluation of the strengths and weaknesses of each alternative considered, the project team recommends that the engineering standards-setting functions be retained in REA at this time.

Other - Additional items for further consideration by the Administrator are included in the report.

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STUDY OF ENGINEERING STANDARDS FUNCTIONS

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STUDY OF ENGINEERING STANDARDS FUNCTIONS

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Objectives of Study

On January 16, 1985, the Administrator selected four REA employees, Larry Sevier, Chief - Western Area Telephone Operations, Craig Wulf, Management Analyst - Telecommunications Management Division, Tom Nusbaum, Chief - Northeast Area Electric Operations, and Bob Lozier, Chief - North Central Area Accounting, to study REA's engineering standards-setting functions Throughout this report, the above employees will be referred to as the "project team." The Administrator directed the project team to examine all aspects of REA's technical standards-setting program as it now functions, and to make two determinations:

1. Whether a need for standards-setting exists in the rural electric and rural telecommunications programs.
2. If there is a need, whether the responsibility should more properly rest with the public sector or the private sector.

The project team was responsible for developing the study methodology and determining what organizations should be contacted. The Administrator asked that the final report be available for his review on or about March 1, 1985.

Scope of Study

The scope of the study was limited to the need for engineering standards-setting functions and, if a need existed, where the engineering standards-setting function should more properly be performed taking into account present REA objectives and policies. These functions are presently the responsibility of the Engineering Standards Division (ESD) in the Electric

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Program and the Telecommunications Engineering Standards Division (TESD) in the Telephone Program. The study did not include any review or evaluation of the effectiveness and efficiency with which these responsibilities are carried out by ESD and TESD.

Our assignment to conduct this study was made before the President submitted his budget for Fiscal Year 1986 to the Congress. That budget request includes a recommendation that REA be "phased out" by 1990. Any decision or discussion concerning engineering standards, because of this recommendation, is thrust into an arena different from that when our assignment was made. Decisions concerning engineering standards, staffing assignments, and functions of the agency now involve a new policy declaration of the President and recommendation to the Congress. The project team, in the collection of data and information compiled in this report, did not in any way consider this new recommendation of the President because doing so, we felt, involves higher level policy considerations beyond the scope of our assignment.

Methodology

The project team gathered data through interviews (in-person and by telephone), written survey forms and collection of existing papers and publications concerning engineering standards. The project team attempted to contact individuals from any organization that is or could be affected by engineering standards, either directly or indirectly. The following list shows the variety and number of organizations contacted:

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1. REA Staff - 21 Washington staff (2 Assistant Administrators, 2 Deputy Assistant Administrators, 10 Area Directors, 7 key ESD and TESD staff), and all REA General Field Representatives (GFR's) (28 out of 41 Electric GFR's responded; 30 out of 47 Telephone GFR's responded).
2. Electric and Telephone Utilities:
   REA Borrowers - 20 Electric, 22 Telephone
   Non-REA Borrowers - 2 Electric, 2 Telephone
3. Consulting Engineers - 10
4. Contractors - 4
5. Regulatory Commissions - 3
6. Other Lenders - 6 [includes Wichita Bank for Cooperatives and National Rural Utilities Cooperative Finance Corporation (NRUCFC)]
7. Borrowers' Trade Associations - 3 [United States Telephone Association (USTA), National Telephone Cooperative Association (NTCA), National Rural Electric Cooperative Association (NRECA)]
8. Standards-Setting Groups - 3 [Electronic Industries Association (EIA), American Society for Testing and Materials (ASTM), Institute of Electrical and Electronic Engineers (IEEE)]
9. Other Government Agencies - 6 [Farmers Home Administration, Soil Conservation Service, Agency for International Development, State Department, National Communications System, National Bureau of Standards]
10. Utility Attorneys - 4
11. Other Organizations - 9 [International Brotherhood of Electrical Workers (IBEW), American Public Power Association (APPA), Power and Communications Contractors Association (PCCA), ComQuest, Association

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of Communication Engineers (ACE), North Carolina Association of Electric Cooperatives (NCAEC), Tarheel Electric Membership Association (TEMA), Western Rural Telephone Association (WRTA), Oklahoma Association of Electric Cooperatives (OAEC)]

The project team conducted interviews in Raleigh, North Carolina; Oklahoma City, Oklahoma; Wichita, Kansas; Reno, Nevada; San Francisco, California; and Washington, D.C. These locations were selected in order to contact the greatest number of organizations within the time frame of the study and still have the widest geographic representation possible.

Agency Objectives and Guiding Policy

In order to conduct a proper study, the project team had to identify current REA policy and objectives applicable to the issues being studied.

REA's Guiding Policy Statement for its Relationship with its Borrowers, Bulletin 2-1 (Electric): 301-1 (Telephone), has specific bearing on the engineering standards functions. Following is an identification of the various sections of this document which have affected the project team's study of engineering standards:

> II. Objectives: The objectives of the Rural Electrification Administration programs are to provide, through self-liquidating loans under the Rural Electrification Act of 1936, as amended, and through technical assistance, adequate, dependable electric and telephone service sufficient to meet the needs of beneficiaries of the Act, both farm and nonfarm, in rural areas on an area coverage basis, under rates and conditions that permit full and productive use of these utility services.
>
> III Policy: To achieve program objectives and to protect loan security, REA will in its relationships with borrowers, base its activities on the following considerations:
>
> A. That each borrower is: (1) an independent corporate body subject to all applicable laws and regulations; (2) responsible for the

efficient and effective management of its own affairs, including proper and successful construction and operation of its system; and (3) expected to repay all indebtedness on or ahead of schedule according to the terms of its loan(s) and established policy.

B. That REA activities will be carried on in a manner to help develop the resources and ability of borrowers to meet their needs, handle their own affairs effectively, and achieve as soon as possible the internal strength and soundness to assure its success as an independent enterprise. As borrowers develop adequate internal strength and financial soundness, direct REA assistance will diminish accordingly.

C. That as required REA will furnish technical and management assistance to borrowers to help further the objectives of the Rural Electrification Act and protect the security of the Government's loan.

D. That REA will establish terms and conditions in loan security documents and policies and procedures to assure the proper implementation of its objectives.

F. That REA policies and practices will be designed to protect the interests of consumers and the public, and to develop and protect the image of the program in terms of the objectives of the Rural Electrification Act.

REA Bulletin 44-7 (Electric) and REA Bulletin 345-3 (Telephone) also set forth policy and procedures for standards-setting by REA. Both bulletins clearly establish that standards of existing national standards groups will be used "except where experience has indicated that they are not adequate for materials and equipment to be used on rural systems." These documents also provide for REA to set standards where no national standards exist or where significant savings will result from developing a new standard.

Definition of Standards

Webster's New Collegiate Dictionary defines standard (n) as "...3. Something established by authority, custom, or general consent as a model or example: criterion, 4. something set up or established by authority as a rule for the measure of quantity, weight, extent, value or quality."

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Standardization is defined as "the process of formulating and applying rules for an orderly approach to a specific activity for the benefit and with the cooperation of all concerned."

Standardization activities in the United States are very complex and decentralized. There are more than 750 organizations which make up the U.S. standards system. In 1983, approximately 420 non-government organizations maintained an estimated 32,000 standards. In addition to these, there are almost 49,000 standards developed by Federal agencies, of which more than 38,000 have been developed by the Department of Defense. Approximately 20 major non-government standards developers have developed over 26,000 standards, which represents more than 80 percent of all standards developed in the private sector.

There is a question as to how much overlap exists in standards between the Federal Government and the private sector. In fact, there is a high degree of overlap between non-government standards and military standards and specifications, (e.g. more than 70 percent of the military documents define commercial products and materials). Partially as a result of a Government-wide concern that overlap did exist in the standards area, the Office of Management and Budget (OMB) issued its Circular A-119, dated January 17, 1980. Circular A-119 states, in part, that "Federal use of voluntary standards, whenever practicable and appropriate reduces the cost of developing and using standards and, thereby, serves the public interest." The OMB circular encourages "Federal participation in supporting and participating in voluntary standards bodies."

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The National Bureau of Standards is the Federal Government's coordinator for standards activities. They have stated that "while non-government organizations have developed thousands of essential standards defining testing, safety, terminology, and other requisite characteristics, it is estimated that less than 20 percent are fully definitive product standards suitable for competitive procurement." REA entered the standards-setting arena for exactly the same reason that so many other government and non-government organizations became involved. While there are many private sector standards-setting organizations, none of these produce standards which address construction design or specifically address how component parts should be assembled for application on a rural telephone or electric system.

Procedures for developing standards differ according to the type of organization setting the standard and the intended application for the standard. Methodologies for developing standards could be broken into three broad categories:

1. Voluntary consensus standards - these are developed in a completely open environment where fair representation is given to all affected parties. The use of these standards is voluntary. Examples of standards-setting organizations using this methodology would be the American Society for Testing and Materials (ASTM) which is the largest private sector standards-setting organization, the Electronic Industries Association (EIA) which is a trade association of electronic manufacturers and the Institute of Electrical and Electronics Engineers (IEEE).

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2. Mandatory standards - these are developed by an organization and are imposed on itself or others. Examples would include many military specifications written to meet critical needs for strategic projects.

3. Other combinations - There are many other methodologies that fall in between the first two types of organizations listed. Many standards which are developed under a consensus, voluntary approach may become mandatory standards if adopted by another organization. For instance, many Federal, state and local regulations and codes are based on standards developed by voluntary organizations.

Where a national standard does not exist, REA develops a new standard, but widely circulates drafts throughout the industry for comment and makes a sincere effort to resolve any negative comments prior to implementation. The manufacturers, borrowers, consulting engineers and REA field personnel have an opportunity to comment before a standard is established as final. At that point, the standard becomes mandatory to the extent that a borrower cannot receive loan funds if the standard is not adhered to. Unlike many other mandatory standards in our economy, REA borrowers are free to deviate from REA standards if they do not intend to finance the affected facility with Federal funds.

The standards-setting program, as it now exists in the REA electric and telephone programs, includes the following broad categories:

1. List of Acceptable Materials; Material and Equipment Specifications for items on the materials list. The specifications are the performance criteria for the materials and equipment. The List of Materials sets

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forth the manufacturers and their products that meet the performance criteria.

2. Standard Construction Specifications and Drawings (For study purposes, also includes the Telephone Engineering and Construction Manual and Telephone Design Standards).
3. Standard Contract Forms
4. Standard Bidding Procedures

While these functions are distinct, separate areas, they have evolved, over the years into a closely interrelated matrix of activities. For instance, the standard construction specifications and drawings, by reference, include materials on the REA Materials list. Similarly, the REA standard contract forms require contractors to utilize the standard construction specifications and drawings. Standard bidding procedures were developed in such a way that prospective bidders must submit bids based on standard construction units and acceptable materials.

For the purposes of this report, all future references to standards will encompass the four broad areas of standards activities described above.

Standards Divisions and Standards-Setting Efforts

The TESD staff totaled 31 people including clerical personnel as of September 12, 1984. The annual professional staff effort dedicated to standards-related function is approximately 8 staff years according to TESD.

The ESD staff totaled 27 people including clerical personnel as of September 27, 1984. Approximately 8 staff years are dedicated to standards-related functions according to ESD.

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Benefits (Non-Benefits) of Engineering Standards

The following sections on benefits and non-benefits of engineering standards represent the views expressed by those contacted by the project team.

Benefits (Non-Benefits) of Engineering Standards to REA

There was agreement among the REA personnel contacted that the existence and utilization of standards (standardization) provides the following significant benefits to REA:

- Facilitates determinations that loan amounts are limited to the lowest level possible which still enables accomplishment of program objectives; thereby, minimizing the possibility for waste and abuse of Government funds.
- Enables staffing, necessary to review and process loans and advance of funds requests, to be kept at a minimum level while maintaining the productivity and efficiency to meet the requirements set forth in existing policies and procedures.
- Allows program employees, non-engineers and engineers who do not have construction and design experience, to carry out their program responsibilities.
- Enhances loan security and provides a framework for increased financial viability to enable borrowers to obtain additional funding from sources other than REA.

The above benefits are interrelated in the various processes that occur from the time an organization conceives the need for a loan until the loan is repaid. The REA employees stated that adherence to the material standards, construction standards, standardized construction contracts and required bidding procedures produces a known result. That result is utility plant that

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will provide quality service in rural areas at the most economical cost and that will last for the life of the loan. It was emphasized that REA standards are geared to rural applications and that none of the four standards activities could be eliminated without affecting the remaining ones.

Further, the presence of the standards enables REA to minimize its review of projects from development through the expenditure of loan funds. This is accomplished by use of certifications from borrowers, consulting engineers, contractors and others that the facilities have been constructed in accordance with the established standards. Without standards, certifications would not be possible. Without the reliance on various certifications by others, REA would have an increased work load. Other functions of the current staff would either have to be reduced in order to handle the additional work or more staff would have to be hired, probably in the field. These employees would require significant technical training.

The primary documents supporting a loan application are the Area Coverage Design or Supplemental Loan Proposal in the telephone program and the two-year construction work plan in the electric program. REA employees believe that standards make it relatively easy to review a loan application to determine whether the cost estimates are realistic. Without the standards, individual borrower and consulting engineer cost estimates would reflect an unknown quantity and quality of plant. An in-depth review of each application by REA would be required to determine that quality plant constructed at reasonable cost would be the end result. The review would take more time and would probably have to be performed by an engineer with expertise in construction and design activities.

The review and approval of plans and specifications is also affected by standards. With engineering standards, a judgment can be made with regard to overall design quality and general adherence to an accepted standard. Without standards, the job would basically have to be re-engineered to arrive at a judgment.

Loan funds are advanced primarily for two types of construction: (1) contract construction and (2) force-account (work order) construction. Standardized construction contracts based on material and engineering standards require a minimal review time with emphasis on the non-standard items therein. The REA employees expressed the opinion that if contracts were not standardized and based on engineering standards, then an in-depth engineering and legal review of each contract would probably be necessary to provide assurance that the Government's interests were protected. The standard construction contracts enable comparison of bids and contracts because they are based on like construction units, and minimize the likelihood of disputes and litigation.

The borrower's consulting engineer certifies on the Certificate of Completion Contract Construction that:

> "The construction provided for pursuant to Construction Contract No. _____ dated __________, including all approved amendments, (hereinafter called the Project) between _____________(owner) and _______________ (contractor) has been completed as of _______________, and is in all respects in strict compliance with the provisions of the Loan Contract and the Construction Contract, including all plans, specifications, maps, and drawings and all modifications thereof."

In the electric program, loan funds are advanced for force account construction and many construction contracts based on the costs set forth on the Inventory of Work Orders (REA Form 219). The Inventory of Work Orders contains the following certification by a licensed engineer:

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> "I hereby certify that sufficient inspection has been made of the construction reported by this inventory to give me reasonable assurance that the construction complies with applicable specifications and standards and meets appropriate code requirements as to strength and safety. This certification is in accordance with acceptable engineering practice."

In the telephone program, REA Form 771a - Summary of Work Orders (Inspection by Licensed Engineer or Borrower's Staff Engineer) contains the following inspection-certification:

> "I hereby certify that sufficient inspection has been made of the construction reported by this summary to give me reasonable assurance that the construction complies with applicable specifications and standards and meets appropriate code requirements as to strength and safety. This certification is in accordance with acceptable engineering practice."

The vast majority of work order construction in the telephone program is still approved by REA field employees. The General Field Representative makes the following certification on REA Form 771 - Summary of Work Orders:

> "The above construction or purchase has been reviewed and is approved from an engineering standpoint."

An REA General Field Representative expressed the consensus opinion of the REA employees about work order construction review and certification as follows:

> "By having standards, the reviewer of work orders can, with experience, detect unreasonable or unusual cost figures. Spot checking or sampling of construction can be meaningful. With no standards the approval would be a meaningless paper exercise or a detailed nut and bolt inspection. Neither of these extremes seem very attractive or useful. Without standards, to what does one certify?"

We heard repeatedly that quality constructed plant that will enable the providing of adequate, reliable service at reasonable cost is the cornerstone of loan security. Even though our lien is on the physical plant, the real loan security is vested in the ability of that plant to provide service that will generate the revenues necessary to repay the loans. Good standards provide the basis of this security. If there are no standards or the standards are inadequate, the result would probably be either underbuilt plant

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(inadequate to meet service requirements or life expectancy) or overbuilt (gold-plated) plant. Either situation could result in much higher rates. Excessively high rates are a definite threat to loan security.

There was agreement among the REA employees that elimination of standards would not result in an immediate threat to loan security. There was, however, considerable disagreement among the REA employees as to what length of time would elapse before loan security problems, due to inadequate plant and the resultant poor quality service, would surface. The time frame most frequently expressed was five to seven years.

In addition, it was the opinion of many that elimination of standards would be counterproductive to REA's stated goal of having borrowers achieve the financial soundness that will enable them to obtain greater amounts of financing from sources other than REA. Inadequate plant would likely result in one or more of the following:

- Higher capital investment costs due to plant having to be replaced at quicker intervals than quality plant would require.
- Higher operation and maintenance costs required to maintain the plant in adequate operating condition.
- Reduction in ability to generate sufficient revenues to cover costs and improve equity position due to customer dissatisfaction with the quality and cost of service rendered by the utility.

Existence of the above conditions would seriously affect the credit-worthiness of the REA borrowers.

The existence of standards can produce a two-sided cost effect. Standards may increase construction costs over what they would be without standards, because

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without standards, a company might use cheaper materials and construction methods. But standards can also decrease costs of construction by lowering the expenses of manufacturers, consulting engineers, and contractors. Thus, with standards, one can obtain higher quality at a lower cost than would otherwise be possible. This, however, only considers initial cost. In the long run, costs should also be lower because with higher quality products and construction, plant should not have to be replaced as often. These factors can affect the size of loans made by REA and the interest rate at which they are made.

The standards also allow borrowers to more accurately determine what new facilities are appropriate and necessary. On an overall scale, a standardized SAVE concept for rural telephone systems proved beneficial in reducing costs. Furthermore, standards enable REA to more confidently make determinations that designs and cost estimates are correct. Over-estimation of plant required or costs could also increase the amount of loan applications, or affect interest rates.

The concern over loan amounts is significant to both the electric and telephone programs, but the interest rate issue may be more important to the telephone program. In order for a borrower to receive a loan from the Rural Telephone Bank it must have a projected TIER of 150 percent. Unnecessarily inflated construction costs mean higher depreciation and interest expenses, which translate into a lower TIER. This would make fewer borrowers eligible for RTB loans. Additionally, if poor quality materials and construction were allowed, maintenance expenses would likely increase, resulting in a similar drop in TIER. Installation of poorer quality plant would also probably cause borrowers to come to REA more often for loans to improve their systems.

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Benefits (Non-Benefits) of Engineering Standards to Other Lenders

The project team interviewed individuals knowledgeable in the commercial banking arena to ascertain what their lending considerations were, the types of loans they might consider and whether engineering standards were a factor in their decision process. Generally, engineering standards are not a major concern to commercial bankers in making loans to utilities. However, standards are a primary concern to Banks for Cooperatives and the National Rural Utilities Cooperative Finance Corporation (CFC).

Commercial bankers indicated that for a utility construction loan they would want the following information:

- Outline of Project
- Architectural design
- Outline of Benefits
- Feasibility study examining both financial considerations and the need for the project (including demographics, load factors, rates)
- Assurances that the construction project will be built to plans and specifications and completed on a timely basis. (All inspection costs are paid by the construction firm.)

The commercial banker's primary concerns would be 1) whether the project to be financed would generate enough revenue to repay the debt and 2) what the ratio of the cost of the new project is to the existing plant value. The second concern revolves around a consideration of whether the new construction will pay for itself.

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Two types of loans might be considered:

- Construction loan over 2-3 year period with the loan sold at the end of the third year.
- Construction loan over 2-3 year period with loan held by lender through term of loan (approximately 10 years total).

Commercial banks would normally finance 70-75 percent of the project. The remainder would usually come from internally generated funds.

Standards play some role in bond rates; however, it is not significant. Feasibility of the project is the most important consideration.

Commercial bankers interviewed by the project team stated that the primary consideration in any loan to utility borrowers would be cash flow. Will sufficient cash be generated to pay operating costs and debt costs? The cash flow analysis would consider such things as the quality of the plant assets as a vehicle to generate the necessary revenues, the potential for the borrower to obtain the proper rate levels, operation and maintenance costs, and demand for the borrower's product. To summarize, the bank wants to have assurances that the borrower will be in business for the life of the loan and will be able to repay the loan. The bank does not want to own a utility. Assuming the above conditions were satisfied, the bank might consider a loan for a period of 5-7 years with a variable rate of 1 1/2 percent or more above the prime lending rate. The commercial bankers indicated they would not consider a loan to a utility in excess of 10 years. Engineering standards were not an overriding concern to them. The primary concern is not quality of service to the utility customer, but repayment of the loan.

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The project team also interviewed supplemental lenders actively involved in the REA program. The Wichita Bank for Cooperatives (BC) indicated that they have relied on the REA findings of project needs, feasibility and loan security. BC's are not currently staffed to perform all of these functions. They had not established a position as to what their reaction would be if REA decided to eliminate engineering standards. The BC did indicate a willingness to become more actively involved in the lending aspect if REA continued to provide the loan findings.

CFC indicated that they are extremely interested in engineering standards. The CFC board indicated, by resolution, that its present and future loan security is dependent, in part, on REA's continuation of the standards functions. CFC, like the Banks for Cooperatives, has relied primarily on REA in that if the borrowers have met REA's engineering and feasibility requirements, CFC had no real concerns. CFC does prepare a separate feasibility study, but it closely follows REA's study. CFC stated that it was understood in the trustee agreement with their bondholders that the plant financed with CFC funds would be built to a certain quality and maintained at a certain level.

CFC representatives also stated that they would have an interest in developing mortgage language that would allow CFC to have some controls in the specifications and materials areas if REA does not continue to serve those functions.

Benefits (Non-Benefits) of Engineering Standards to Borrowers

There was widespread support by the borrowers for keeping standards in the Electric and Telephone programs. The borrowers identified the following

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benefits of standards, most of which are applicable to both telephone and electric systems:

- Quality of service at a reasonable cost.
- Lower cost of construction.
- Lower maintenance expenses.
- Lower replacement costs.
- Lower rates resulting from longer life equipment and better design.
- Interchangeable equipment.
- Employee training benefits.
- Lower labor costs in the purchasing area.
- Creates pool of skilled technicians.

There were also issues involving safety, maintaining lower inventories of equipment, and rates that are discussed in more detail below.

Borrowers operate in small rural communities and have limited resources on which to draw for expertise. Standards which will assure them that the plant they construct is of good quality, is properly constructed and will last through the length of the loan is critical to their needs. Most cannot afford an engineering staff to analyze new products or construction design, and to ensure that the construction is of the quality they need. Many are concerned that, without standards, inferior products and poor construction practices will result and eventually service will deteriorate.

Many borrowers expressed strong beliefs that if there were no list of acceptable materials maintained by an independent, neutral organization which has the respect and confidence of the entire industry, they would be subject to the influence of high-pressure salesmen or other salesmen unfamiliar with new technologies. Some managers expressed the concern that some board members could influence the purchase of inferior equipment in the interest of realizing short-term savings, especially in areas where borrowers' rates were higher than neighboring utilities. Most borrowers believed that they, unlike larger investor-owned utilities or large holding companies, could not maintain a staff to evaluate all of the products on the market, especially in an era of rapid technological changes. Borrowers gave many examples where just the threat of possible delisting from the Materials List, has caused many manufacturers to quickly resolve maintenance problems on their products, even though the warranty period may have expired.

Many borrowers cited the rural cable television industry as an example of poor construction practices, poor quality material and resulting construction costs which are much higher than should be because there are no national standards. Many do not even meet electrical codes. Most rural cable TV companies are set up to get in and out in a relatively short time frame, possibly 10 years. Then, if it deteriorates and results in much higher maintenance, the owners may sell to another firm. It has been termed as chaos by many in the rural telephone industry who are concerned with the direction CATV operators appear to be going without standards.

Many borrowers feel the telephone industry is in a technological revolution with so many emerging products, such as, fiber optics cable, digital switching, satellite communications, and electronics, that it is impossible to keep up with them.

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An example of where a standard has been eliminated is the telephone instrument. Since the instruments were deregulated, REA no longer finances them and, therefore, no longer maintains them on the List of Acceptable Materials. Telephone companies report that an increasing amount of inferior equipment is finding its way onto their systems via the subscriber. This has caused a tremendous problem analyzing customer complaints, isolating it to the customer premises, and convincing the customer the problem is in the instrument. In many instances, instruments may work in urban areas, but are not designed for long loops or carrier application in the rural areas. Borrowers are concerned such problems could extend to their overall systems without standards. Another example is the Network Interface Device to be installed at the consumer's residence or business, making it convenient for them to connect with the telephone companies. No one in the industry has written a specification for this device even though there are numerous devices on the market. This is another example of a potential problem which could result in poor quality.

Most borrowers believe that hand-in-hand with the decrease in quality of service will be a sharp rise in maintenance expense. Without standards, most borrowers believe that, over a period of time, their respective boards or management staff will make poor decisions regarding the purchase of quality equipment or the use of good construction practices. They will do this either intentionally to save money in the short run, or unintentionally because they lack the knowledge and experience to make an informed decision. An effect of these decisions will be increased maintenance costs, 5 to 10 years down the road.

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Borrowers are also concerned that cost of construction will increase if standards are not set by a national organization. They believe that the manufacturers are able to gear their assembly lines to mass produce similar products for a large market, thereby reducing the manufacturing cost.

Contractors are more efficient because every job bid is uniform to the standards. Consulting engineers realize many efficiencies when relying on standards. The results are cost savings to the borrower, lower loan demand, and less depreciation and interest expenses. These savings can be passed on to the consumer to help keep the cost of service at a reasonable level.

Safety was a more critical issue to the electric borrowers due to their work in high-voltage situations. In emergency or disaster situations, crews from neighboring cooperatives who are familiar with standard materials and standard construction design, can quickly restore service under safe conditions because of their knowledge of the system construction. An example was cited where a borrower on the North Carolina coast was hit by Hurricane Diana during 1984. Approximately 32,000 of the borrower's 35,000 total consumers were out of service as a result of the storm damage. Responding to a call for assistance, 204 employees from 14 electric cooperatives in North Carolina brought trucks loaded with standard equipment and restored service within four days. Line work is not as dangerous for telephone companies. However, manholes can present significant safety hazards, and standards can reduce these potential hazards.

Borrowers also expressed a genuine concern for the safety of people living in the rural areas. Borrowers do not consider the telephone a luxury item. The telephone is needed to contact doctors, ambulances, fire departments and police. If the telephone system does not work properly, they believe customers could be facing life threatening situations.

The borrowers stated that with national standards, there are many other benefits such as; fewer customer complaints, lower replacement costs, lower rates, ability to mix manufacturers equipment, and a pool of skilled technicians in the industry. Standards also facilitate field trials of new materials and equipment before they are subjected to widespread use in the industry. This approach has saved many companies tremendous problems by enabling the manufacturers to correct problems during the field trial stages before final distribution of the product.

The borrowers mentioned that they can maintain lower inventories of equipment with the knowledge that, in an emergency situation, equipment can be obtained from other REA-financed systems in their area. In the area of purchasing materials, we heard that purchasing agents presently do not need engineering expertise or detailed knowledge of equipment performance capabilities because they can rely on the list of acceptable materials.

Many borrowers expressed the concern that, if there were no standards, rates would be severely affected. For most of the areas identified above, the borrowers believe that any rate disparity that presently exists between them and their neighboring utilities would be further exacerbated without standards.

When asked to rank the four major standard-setting functions as to their relative importance, the majority of the borrowers indicated that the

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functions could not be separated. They are so interrelated that to do away with one would damage the entire standard-setting procedure. For example, if REA did not maintain a list of acceptable materials, the bidding procedure would become meaningless because there would not be uniform bids which may result in comparing apples and oranges. Without standard contracts, outside plant bids could not be compared with any meaning. Construction methods would vary tremendously. However, most borrowers believe the List of Materials and the Construction Drawings are the most critical; the standard contracts and bidding procedures are the least critical. This differentiation was most significant for those borrowers doing a considerable amount of force account construction.

Borrowers indicated that, in most instances, they adhere to REA standards even when general funds are used to finance utility plant construction because the use of standards assures quality plant and the borrowers want uniform systems.

A few borrowers believe that REA's material and construction standards are overly restrictive. They indicated that, on occasion, they would like to employ methods and products not allowed by REA.

Benefits (Non-Benefits) of Engineering Standards to Consulting Engineers

All of the consulting engineers contacted felt strongly about the need for standards in the rural areas. They reported that standards have played a very important role in the development of rural areas and should continue to do so in the future. The consulting engineers believe the presence of standards has specific benefits to them:

- Creates uniformity among consulting firms. Without national standards, the consulting engineers think there may be as many methods of

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construction as there are consulting firms. This would increase the costs of construction because many projects would be bid differently by the contractors. Also, the consulting engineers would be required to perform more detailed design work than presently required. The use of computers in design and estimating is facilitated by standards.

- Eliminates the need for consulting firms to research products to determine if the performance claims of the manufacturers are valid. If there were no standards, the consulting engineers would need larger staffs. Increased costs would be passed along to the borrowers who would, in turn, pass them along to the ultimate consumers.
- Offers added security to consulting engineers in a liability situation. During litigation, they can satisfy much of their responsibility by indicating that the standards which they are required to follow are the responsibility of a Federal agency and that their certification is based on compliance with those standards. If they had to develop their own standards, their "at risk" liability would be greater, resulting in higher fees charged to their clients. Such a situation would probably cause a trend toward over-design by the consulting engineers resulting in increased costs to their clients.

Benefits (Non-Benefits) of Engineering Standards to Contractors

We contacted several contractors of varying size who perform work in both the electric and telephone industries. They were unanimous in their belief that national standards enable them to function efficiently and effectively. Primary benefits cited included lower training expenses, smaller staff requirements, increased expertise, reduced and more manageable materials inventory, less chance of litigation, and greater ease in bidding projects.

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Standards allow contractors to lower costs because less training is necessary for personnel. Once the contractor has trained its employees on construction methods based on national standards, there is no need to retrain them unless new standards or methods are developed. If there are no standards, and construction methods differ from one area to another, it would take time and money to train employees to handle the varying situations which would exist.

Standards allow contractors to reduce staff requirements, and thus costs. Because a construction unit is the same in all parts of the country, contractors can bid a job in a minimal amount of time. It specifically reduces the number of estimators needed to bid the same number of jobs. Standards also facilitate the use of computer programs in estimating costs.

Standards increase staff expertise. With fewer things to learn, the contractor's personnel become experts at what they do, and can do it much more efficiently. When personnel install the same unit several times, they become proficient at it. Overall, it is easier to work on standardized projects. Ultimately, this is reflected in the bid prices.

Standards reduce the types of materials that must be stocked while allowing a larger amount of required materials to be retained. When a contractor bids a job, he is not concerned about pricing his bid substantially higher because he may have excess materials left over that cannot be used elsewhere. If he has a thousand feet of cable left over on a job in one state, he is assured that this cable can be used on a job in another state because of the existence of standardized materials. Additionally, contractors do not have to keep a supply of many kinds of materials to satisfy preferences of individual

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utilities, nor maintain the different types of tools and equipment which might be required to install these materials.

Standard contracts have reduced the amount of dispute and litigation in the industry simply because the contracts spell out very clearly what is expected and which party is responsible for what. This again allows the contractor to keep costs at a reasonable level which is reflected in his bid prices. Contractors would be very hesitant to bid a job without standards unless they protected themselves through a higher bid.

Standards create a more mobile market for contractors. Without standards, contractors would be hesitant to go into geographic areas where they are not familiar with the construction practices and legal requirements. They would reflect these concerns in the bid prices to protect themselves against bankruptcy. The contractors believe standards have allowed them to remain active in a competitive market.

Some contractors utilize REA standards on non-REA projects. They are concerned with maintaining good reputations for sound construction practices. Some contractors that do not follow REA standards on other non-REA projects may be dropped from the consulting engineer's bid list because their construction quality is not high enough.

Contractors also believe that without standards, even though the cost of construction may be higher, the quality of service may deteriorate. One concern is that the rural industry may end up with a thousand different types of systems being built instead of one universal system. Many of the contractors believe that in order to compete, particularly with no list of acceptable materials, less expensive and probably inferior products will be substituted in order to successfully get the job. This could result in lower quality of service to the end user.

A large contractor, who has performed work for 45 to 50 REA borrowers, 9 investor-owned utilities, and many municipals, compared his company's successful bids for REA cooperatives to the company's successful bids for IOU's. These groups were compared because system designs were almost identical in rural areas. The municipals, however, were so different from system to system that there was no basis for comparison. It was found that on a cost per mile basis, costs on the REA jobs were 5 to 9 percent less than on the IOU's. The contractor did mention that the cost of construction for the municipals was much higher than REA projects. This is directly related to the lack of standards for the municipals.

Benefits (Non-Benefits) of Engineering Standards to Suppliers and Manufacturers

The suppliers and manufacturers contacted stated that there was a definite need for standards within the rural industry. Standards keep the cost of manufacturing a product at a reasonable level and have a tendency to keep inferior products out of the market place.

The cost of manufacturing a product can be kept to a reasonable level if the manufacturer can standardize to a particular specification. They have the advantage of high volume production and a readily available inventory. For example, a considerable amount of money is spent on research and testing. If there is a benchmark, such as a standard, the manufacturers do not have to

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retool their production line each time a request is made for their product. This saves a tremendous amount of money. One switch manufacturer, for example, indicated that it sells to the Bell market, the large independent market, and to the small rural independent market. It has a different standard for Bell, for the large independents and for the small independents. If there were no standards for the small independents, the manufacturers may have 1,000 different specifications to meet, and the cost of production would be much higher.

The same manufacturer indicated that if tne small telephone companies were to adopt the standards of the Bell system, the cost of the switches would be higher. Bell has designed its standards toward the urban areas, and while the switches may work in rural America, there are many unneeded features for which the borrowers would pay. While Bell can absorb these costs with no adverse financial effects, the small telephone companies may be adversely affected.

Manufacturers also were concerned that everyone be on the same "level playing field." The List of Acceptable Materials assures that quality products will be competing against quality products. Inferior products will not be competing with quality products. They stated that standards have definitely improved the quality of construction and equipment in rural systems. Standards have resulted in lower bid prices, lower maintenance costs and savings to the rural companies resulting in reduced rates to consumers.

The List of Acceptable Materials is the standard item that is of the greatest concern to manufacturers. One major manufacturer noted, however, that it does not create a product from scratch just to get something listed. Rather,

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listing is of secondary concern in product development. Listed products might have minor mechanical or electrical differences from non-listed products made for others in the industry. These deviations are minor enough so that overall production methods are not significantly affected. This manufacturer claimed that the lack of a list of acceptable materials would be a disadvantage to both manufacturers and borrowers, since with it, borrowers have a degree of standardization other utilities do not enjoy. Even without a list, this manufacturer would encourage REA borrowers to continue using standardized products (considering the benefits to both parties). The manufacturer did note, however, that currently it does not push listed items on non-borrowers.

Benefits (Non-Benefits) of Engineering Standards to State Regulatory Bodies

The State Regulatory Bodies (Commissions) contacted supported continuance of national standards in the Electric and Telephone programs. The commission staffs identified the following benefits of standards:

- Provides a consistency of construction criteria. With the same criteria for all companies, construction costs can be kept to a minimum, thereby reducing the need for debt financing, which in turn, would result in lower rates to the consumer.
- Provides the basis for quality of service reviews. This is important to commissions as most have a quality of service review program. Their review is greatly aided by a national standard and helps reduce the number of staff personnel needed.
- Assists in the survivability of small rural utility companies. Commissions are concerned that rates are getting to a point of being unaffordable. The discontinuance of national standards would have a further negative effect on rates.

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- Provides an excellent tool for training rural utilities personnel. Technicians are not easy to find in rural areas. This avenue of training is excellent for the small utility companies. The commission staff also uses the standards manuals for their own internal training.
- Produces lower cost of rural construction. The commissions cited various examples of cost variations in rural areas, one of which relates to the cost to provide service by the investor-owned utilities. The cost to provide service for IOU's is much greater than the cost to provide the same service by the rural cooperatives. The lower cost to provide service is directly related to the use of standards.
- Assists in preventing bypass by large firms in rural communities. With quality service at an affordable rate, the threat of bypass would be less likely.

The commissions' staffs were concerned about the revenue streams disappearing for rural utilities. They believe that the rural areas should be assured of reliable and affordable utility service. To eliminate standards, at a time when rural rates are already suffering from other forces, could seriously impair service in rural areas. Commissions are seeking every opportunity to keep rates at an affordable level.

Benefits (Non-Benefits) of Engineering Standards to Others

The project team determined that other groups also benefit from the presence of standards for rural telephone and electric systems. Specifically, the Agency for International Development (AID), the State Department, and the National Communications System in the Defense Department, indicated reliance on REA standards.

AID is involved in making loans and grants to assist developing nations. Many of these loans and grants are made for the construction of rural telephone and electric systems. It was pointed out that roads, telecommunications and electricity are the three elements necessary for development in rural areas.

AID encourages use of standardized construction practices and materials specifications especially when a country is completely rebuilding a utility system or where a new system is being constructed. The benefits of standardization realized by American utilities are then available to foreign utilities financed by AID. AID utilizes the standards developed by REA and various utility companies to achieve standardized utility systems. For rural construction, considerable reliance is placed on REA specifications.

While AID uses REA standards and recommended practices on projects throughout the world, the following cases were cited. In Bangladesh, AID financed a rural electric cooperative which was built entirely to REA specifications. This project is in an area previously without electric power. This cooperative has rigidly adhered to REA standards. In both Egypt and Liberia, AID has financed telecommunication projects, which used REA material and construction specifications for construction of outside plant and microwave facilities.

AID only provides financing for those portions of utility projects in developing countries which use American products and construction contractors. REA-recommended practices and procedures have been used extensively to train native craftspeople on the construction, operations, and maintenance of rural systems. This is done whether or not AID provides financing for all aspects of the system.

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The State Department and others stated that REA standards have an affect on international trade. Manufacturers use inclusion of their products on the REA List of Acceptable Materials as a selling point to foster overseas business. When a project outside the United States is constructed in accordance with REA specifications, the materials and equipment utilized will most likely be purchased from American manufacturers included on the REA List of Acceptable Materials.

National Security Decision Directive (NSDD) Number 47 on Emergency Mobilization Preparedness, dated July 22, 1982, states that "it is the policy of the United States to ensure that communications resources be available and adequate to respond to the Nation's needs." To further this end, Executive Order 12472 signed by President Reagan on April 3, 1984, gave the National Communications System (NCS) the responsibility to "seek to ensure that a national telecommunications infrastructure is developed which...incorporates the necessary combination of hardness, redundancy, mobility, connectivity, interoperability, restorability and security to obtain, to the maximum extent practicable, the survivability of national security and emergency preparedness telecommunications in all circumstances, including conditions of crisis or emergency.... To assist in accomplishing its mission, the NCS shall...establish a joint industry-government National Coordinating Center which is capable of assisting in the initiation, coordination, restoration and reconstitution of national security or emergency preparedness telecommunications services or facilities under all conditions of crisis or emergency."

The Executive Order further states that the Manager of the NCS shall develop "plans, procedures and standards for minimizing or removing technical

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impediments to the interoperability of government-owned and/or commercially provided telecommunications systems." The Manager shall also develop "test and exercise programs and procedures for the evaluation of the capability of the Nation's telecommunications resources to meet national security or emergency preparedness telecommunications requirements."

The Executive Order also directed the establishment of the NCS Committee of Principals which "shall consist of representatives from those Federal departments, agencies or entities, designated by the President, which lease or own telecommunications facilities or services of significance to national security or emergency preparedness, and, to the extent permitted by law, other Executive entities which bear policy, regulatory or enforcement responsiblities of importance to national security or emergency preparedness telecommunications capabilities."

National Security Decision Directive Number 97 on National Security Telecommunications Policy, dated August 3, 1983, requires the Manager of NCS to "develop plans, in consultation with the NSTAC (National Security Telecommunications Advisory Committee), for an effective mechanism to manage and control the initiation, coordination, restoration, and reconstitution of existing commercial telecommunications services and facilities to support national security telecommunications leadership requirements."

The Department of Agriculture is represented on the Committee of Principals because of the Forest Service's extensive telecommunications system and REA's expertise in standards development and its involvement in rural telecommunications. The Council of Representatives, made up of high level government employees, serves as a subcommittee to the Committee of Principals. NSTAC serves as an advisory committee to the President. The members of NSTAC are top executives in business, but the committee has many advisors from government, including REA, who attend meetings. REA is kept advised of the proceedings of all three committees.

In order to assure, among other objectives of NCS, the connectivity, interoperability, and restorability of a survivable domestic and international telecommunications infrastructure, standards are necessary. The Office of NCS Technology and Standards and the Federal Telecommunication Standards Committee under the Manager of NCS were established to work in these areas. These bodies are concerned with both government and commercial telephone networks.

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Conclusion as to Need for Engineering Standards

Based on the above findings, the project team concludes that the benefits of engineering standards to REA in accomplishing present program objectives and policies overwhelmingly outweigh non-benefits. Other organizations also receive substantial benefits from engineering standards. However, the benefits of standards set forth in each subsection above, except the subsection titled "Others," also directly benefit REA as they facilitate accomplishment of REA program objectives. A need for engineering standards-setting exists in the rural electric and telecommunications programs.

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Engineering Standards-Setting--Public Sector or Private Sector

In considering whether the responsibility for engineering standards-setting should more properly rest with the public sector or the private sector, the project team believes that primary importance must be focused on REA being able to take full advantage of the benefits provided by engineering standards (as are set forth earlier in this report) in accomplishing its stated program objectives of:

- Adequate and dependable electric and telephone service at reasonable rates in the rural areas
- Protection of loan security

Of importance also are the stewardship responsibilities of the Administrator and all REA employees to see that:

- Expenditures of government funds for both loans and administrative costs are kept to the minimum level possible that still enables accomplishment of REA program objectives.
- Government funds are not wasted and abused in either the lending programs or the administration of the program.

Consideration must also be given to the following facts:

- While non-government organizations have developed thousands of essential standards defining testing, safety, terminology and other requisite characteristics, it is estimated that less than 20 percent are fully definitive product standards suitable for competitive procurements.
- No private organization presently exists that produces standards which address construction design or specifically address how component parts should be assembled for application on a rural telephone or electric system.

To obtain all the benefits of standards, standards must be enforced. REA's enforceability of engineering standards stems from its authority to require that utility plant be constructed to a certain quality if government financing is to be obtained. Enforceability is not an issue in determining whether the responsibility for standards-setting should be in the public sector or the private sector. The Office of General Counsel has informed us that REA's loan documents do not limit who can be the standards-setter. REA could designate any organization as the standards-setting body by stating that loan funds will be made available only for utility plant that meets the standards established by the designated organization. It should be understood that REA does consider, on a case by case basis, exceptions to the standards. The opportunity to make exceptions would still be available no matter who sets the standards.

Large investor owned utilities maintain an internal staff for developing their own standards. Eighty to ninety percent of the REA borrowers are too small to economically justify having their own standards staff. In addition, many of the benefits that standards provide to REA would disappear if REA had to deal with approximately 2,000 standards organizations. Statewide or regional standards-setting organizations are a possibility; however, the benefits to REA would also be severely impacted in this environment. Therefore, alternatives set forth in this report contemplate an organization or organizations that would establish national standards.

Based upon the information obtained during this study, the strengths and weaknesses of the various public and private sector alternatives are set forth below. If the program objectives and related policies are changed, the

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expressed strengths and weaknesses of any or all of the alternatives may no longer be valid.

Other Agencies (Public)

Currently, the only public sector organization setting standards for rural electric and telephone systems is REA. No other government agency has indicated an interest in setting these standards. No other agency has the same objectives as REA. Therefore, there appeared to be no benefits to having any government agency other than REA set standards for rural telephone and electric systems.

A number of government agencies indicated that they could better meet their own objectives if REA were to continue setting standards. For example, the National Communications System indicated that it would be at somewhat of a disadvantage if REA got out of standards work because REA has the only personnel in the government who know the "nuts and bolts" of telephone operations. It was noted that since the divestiture of AT&T, REA's expertise is more important than ever. REA is currently working on three projects for NCS developing Federal Telecommunications Standards.

A consulting engineering firm that performs contract work for the Department of Defense has indicated that the military relies heavily on REA specifications for their telecommunications needs. The project team received copies of bid specification documents used by the Departments of the Army and the Air Force in which the REA specifications were continually referenced.

REA (Public)

The following strengths and weaknesses of REA have been identified:

Strengths

- Ability to control standards
- Timeliness of setting standards
- Independence in setting standards
- Established reputation
- Ability to delist a product
- Motivation for developing standards
- Expertise
- Ease of field trial

Weaknesses

- Continued borrower reliance on REA
- Discourages development of standards-setting expertise in the private sector

Strengths:

Ability to control standards: Control ensures that standards are maintained at the appropriate level, that is, loan funds will not be expended for either inferior plant or "gold-plated" plant. If the standards-setting function is performed by anyone except REA, several questions would have to be addressed in the event that an organization sets a standard not acceptable to REA. Would REA (1) go ahead and make loan funds available for unsatisfactory plant or construction, (2) set its own standard, (3) try to force changing of the standard, or (4) change standards-setter. If REA retains the standards-setting functions, these control questions do not exist.

Timeliness of setting standards: REA, working within its own program, has the ability to move quickly to develop a standard if a need exists. An example is the General Specifications for Digital, Stored Program Controlled Central Office Equipment. A consulting engineering firm stated that this standard was

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conceived and developed by REA's TESD section while the combined resources of AT&T, Bell Operating Companies, large independents, and USITA were still discussing what group would develop the standard and where it would first be implemented, in large toll centers, or large end offices. REA's standard was the de facto industry standard for several years and remains the only widely accepted standard applicable to relatively small switching systems as used in rural areas.

The National Communications System also noted that in setting standards, REA has applied a gentle prodding type of leadership for the telecommunications industry by not settling on the lowest common denominator in technology. It was pointed out that in the last 5 to 8 years, REA has moved the industry from electro-mechanical to digital switching, for the most part skipping the interim step of electronic analog switching which the Bell System was committed to for an extended period. REA was also in the forefront in pushing the use of buried plant. Notably, buried plant is far superior to aerial plant in terms of disaster protection.

With technology changing so rapidly, the ability to react in a timely manner to these changes is extremely valuable. REA can also move quickly on corrective action if an established standard does not result in the required performance level.

Independence in setting standards: REA, by the nature of its program objectives and its structure as a Federal Agency, can be independent in setting engineering standards. Special interest groups (manufacturers, suppliers, consulting engineers, contractors) cannot exert undue influence during the standards-setting process so as to gain a competitive advantage. REA's concern is quality plant at a reasonable cost; it is not concerned with either including or excluding a particular organization via the standards-setting activities.

Established reputation: REA has a highly respected professional reputation throughout the rural utility industry. A large consulting engineering firm stated:

> "We have worked not only for small independent telephone companies but also for large independent telephone companies such as General Telephone Company and Bell operating companies such as Northwestern Bell. Based on our experience with the wide variety of clientele, it is our opinion that no entity other than REA has ever developed a significant and meaningful body of practices, standards, contracts and specifications which are specifically adapted to rural telephony."

This reputation has evolved over the past 50 years. Because of its reputation, REA's new standards are immediately and readily accepted. REA is the only organization that currently develops standards that address low density rural area needs.

Ability to delist a product: Certain procedures must be followed to have a product approved for the List of Acceptable Materials. Once a product has been listed, specific procedures must be followed to remove (delist) a product from the List of Acceptable Materials. The established due process procedures minimize the possibility of litigation when a manufacturer's product is either not approved for listing or is subsequently delisted because the product does not meet the standards for inclusion on the List of Acceptable Materials. Loan funds may be used only for materials on the List of Acceptable Materials; loan funds may not be used for materials that have been delisted. Therefore,

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delisting is a function of the lender. Other standards-setting organizations would be reluctant to delist a product.

Many borrowers, consulting engineers, and contractors mentioned that the fear of being delisted has facilitated the satisfactory resolution of problems with listed materials that did not perform properly. Several examples were given which reflected a satisfactory resolution of problems even with products that malfunctioned after the warranty period. The possibility of being delisted is a constant reminder to suppliers and manufacturers to keep the quality of their product up to standard.

Motivation for developing standards: REA has a motivation which may not exist in other standards-setting organizations. The continuing goal to minimize federal expenditures (loan levels as well as administrative costs) serves as a very effective motivation to constantly seek new ways to provide quality service at the lowest possible cost. REA has developed standards for design criteria which have saved immeasurable loan dollars over the years and have resulted in the provision of affordable electric and telecommunication utility service in rural areas. Two examples cited as being innovative concepts that achieved cost effectiveness in the rural areas were the Serving Area Value Engineering (SAVE) concept and the D-66 loading scheme. These methods, developed by REA, made it less costly to build, thereby placing much less demand on loan funds.

Expertise: REA presently has a professional staff with expertise in development of engineering standards for rural areas. The REA area offices and field staff rely on the Standards Divisions for technical assistance and

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expertise in resolving technical problems. This expertise would diminish without day-to-day involvement in engineering standards setting.

REA also conducts Engineering and Management seminars for various members of the industry which include borrowers' personnel, contractors, consulting engineers and REA field personnel. The purpose of the seminars is to disseminate information on new products that have been listed, new methods and techniques for rural construction, results of new field trials, results of testing new products, and new construction methods being considered. These seminars invite views from a wide audience on new methods being considered. The seminars are a direct benefit to REA personnel and also aid in getting information to borrowers and others on ways to improve services to rural areas.

Ease of field trial: Field trial is a method of evaluating the performance of certain equipment before it receives widespread use in the industry. REA determines the need for a field trial and the number of field trials, and monitors the progress of the field trial. The entire process is an efficient method of determining the reliability of tested products.

Weaknesses:

Continued borrower reliance on REA: REA's guiding policy (Bulletin 2-1:301-1) states:

> "That REA activities will be carried on in a manner to help develop the resources and ability of borrowers to meet their needs, handle their own affairs effectively, and achieve as soon as possible the internal strength and soundness to assure its success as an independent enterprise. As borrowers develop adequate internal strength and financial soundness, direct REA assistance will diminish accordingly."

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Having REA continue to perform the standards-setting function appears to be counterproductive to the goal of increasing borrower independence and diminishing direct REA assistance. Unless the responsibility for setting standards in the private sector is vested at the lowest common denominator (each individual borrower), borrower independence will not be increased. However, direct assistance to borrowers will be transferred from the public sector to the private sector.

Discourages development of standards-setting expertise in the private sector: If REA continues to provide the standards applicable to rural environments, there is no incentive for other organizations to acquire and expand expertise in this area. There presently is no need to incur the cost of developing this expertise.

If a private sector organization were to perform this function, there would be greater impetus to increase its knowledge and expertise in the standards area.

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Engineering Standards-Setting--Private Sector

There are five broad categories of groups that could set standards in the private sector. These are:

- Lenders
- Trade associations
- Standards-setting organizations
- Contracted organizations
- New organizations

Lenders (Private)

We have already established that, due to problems associated with enforceability on a local basis, standards-setting could more properly be administered by a nationally-based organization. The only private sector lenders presently involved in rural utility financing on a national scale are the National Rural Utilities Cooperative Finance Corporation (CFC) and the Banks for Cooperatives (BC's).

CFC is the primary supplemental lender in the electric program. CFC was organized by rural electric leaders in 1969 to provide a supplemental source of capital for rural electric organizations. As of yearend 1984, CFC had 936 members that provide electric services to approximately 23 million consumers. Since its inception, CFC's staff has grown to 125 employees. They have, however, very minimal technical engineering staff capabilities since they have always been able to rely on REA for engineering support in connection with loan findings and member systems' engineering needs.

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The Farm Credit System was created by the Farm Credit Act of 1933. There are three types of banks which comprise the Farm Credit System: Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives. The Farm Credit Administration, an independent government agency, has oversight, audit, and coordinating responsibilities for the entire Farm Credit System.

There are 12 district banks for cooperatives which have independent lending authority for the eligible cooperatives within their respective territories. There is also a Central Bank located in Denver, Colorado, which complements and extends the credit services of the 12 district banks by participating with them in loans which exceed individual district lending limits. The BC's are 13 distinct, regional banks. The BC's make loans to eligible cooperatives whose members are farmers, ranchers or commercial fishermen and who meet certain general eligibility requirements. They will provide financing to eligible rural electric and telephone utilities, but only those organized on a cooperative basis.

The following strengths and weaknesses for private lenders have been identified:

Strengths

- Reduced borrower reliance on REA
- Encourages development of standards-setting expertise in the private sector
- Wider range of viewpoints

Weaknesses

- Lack of ability to control standards by REA
- No cost savings for REA
- Funding problems
- Problems with listing and delisting manufacturers
- Lack of timeliness of setting standards

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Weaknesses

- Uncertain motivation for developing cost saving standards

Strengths:

Reduced borrower reliance on REA: As stated in REA Bulletin 2-1: 301-1, REA's

> "...activities will be carried on in a manner to help develop the resources and ability of borrowers to meet their needs, handle their own affairs effectively, and achieve as soon as possible the internal strength and soundness to assure its success as an independent enterprise. As borrowers develop adequate internal strength and financial soundness, direct REA assistance will diminish accordingly."

Direct assistance to borrowers by REA as it relates to standards will diminish. However, unless the responsibility for setting standards in the private sector is vested at the lowest common denominator (each individual borrower), borrower independence will not be increased.

Encourages development of standards-setting expertise in the private sector: The project team was told repeatedly that the technical expertise needed to develop engineering standards for electric and telephone utilities is available in the private sector. Furthermore, some specific expertise in rural applications, the main concern of REA and its borrowers, exists. At the present time, however, this expertise has not been consolidated in an organization whose objective is to set standards. Any organization established to develop standards would have to hire these experts and support employees. Bringing these individuals together in a single organization in the private sector would more than likely give greater impetus for further developing their expertise in the standards area.

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Wider range of viewpoints: REA currently notifies the general public of proposed changes in standards through notices in the Federal Register, and through direct contacts with borrowers, consultants, contractors, manufacturers, and others. A private sector standards-setting organization could possibly disseminate a notice of proposed changes in standards more widely through newsletters and trade journals. This would encourage a greater range of viewpoints, especially from academia and non-borrower utilities.

Weaknesses:

Lack of ability to control standards by REA: No matter which private sector organization assumed the standards-setting functions, REA would lose a considerable amount of control over standards. If another organization set a standard which REA believed to be unsuitable or did not meet the requirements of the RE Act, REA might refuse to accept it. If this occured, the standards-setter would be less enthusiastic to continue to set standards. REA might then have to find a different group to set standards, and the standards-setting process would have to begin all over again. Although REA would have considerable influence over the process, it would not be in as strong a position to ensure that its goals and objectives were being furthered. In any case, REA would have to clearly state its agency objectives and identify how standards conflicts would be resolved, so the standards-setter could identify which standards to set and how to set them. The problem of control is significant.

No cost savings for REA: REA would realize little or no cost savings from having standards set in the private sector. As implied above, REA would still have to monitor the quality and appropriateness of the standards prepared by

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others. Such a monitoring activity would require maintaining a knowledgeable staff. Additionally, REA would need to be represented on such a body to ensure that its views are heard, and interests protected. Furthermore, REA needs this representation in order to keep its own staff current with the state of the art.

Funding problems: Most lenders would encounter funding problems for their standard-setting activities. We were told by various parties that the cost of setting standards would be more for a private sector organization than is the cost for REA. This is because of the increased number of people who would likely be involved and the increased time spent on the activity. No matter what the cost, funding could be difficult. Lenders would likely increase interest rates or impose some type of fee. This could result in the lender becoming non-competitive. There could also be a problem with those REA borrowers who were not borrowing from the lender that was setting standards. For example, the current primary supplemental lenders (CFC and BCs) do not lend to telephone systems or commercial operations. Those that borrow from the standards-setting lender very likely would be unhappy about supporting a function that all REA borrowers were not supporting financially.

Problems with listing and delisting manufacturers: There are questions revolving around anti-trust laws attendant to the maintenance of a list of materials, as well as problems concerning conflicts of interest. Significant problems occur when a manufacturer's product is delisted. Under REA's current procedures, a manufacturer has a two step appeal process it may exercise. It may first appeal to Committee "B", and, if unsuccessful, then to the Administrator. Because of this appeals process and the deliberative way in

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which the original decision is made, REA has not had a problem with litigation over a delisting. Litigation could be a significant problem for a private sector organization.

Lack of timeliness of setting standards: There is a possible problem with the timeliness of setting standards by a private sector organization. Another lender likely would not set standards by consensus. Therefore, negative comments would not have to be satisfactorily resolved before issuance of the standard. However, as long as REA remains as majority lender, any other lender involved in setting standards would have to resolve REA's negative comments. The time involved in the process of resolving negative comments is significant.

Uncertain motivation for developing cost saving standards: There is a question as to whether a private sector organization would be motivated to create certain design standards that emphasize quality but reduce costs. REA has an interest in minimizing loan funds and, for loan security reasons, in reducing operating expenses of borrowers. Other lenders share the loan security concern, however, they want to maximize loans.

Trade Associations (Private)

There are numerous types of trade associations with their own constituencies. These represent contractors (Power and Communications Contractors of America), consulting engineers (Association of Communications Engineers), manufacturers (different ones for different segments of an industry), and borrowers (National Rural Electric Cooperative Association, United States Telephone Association, National Telephone Cooperative Association, and also a number of smaller telephone associations). Fragmentation of the standards-setting functions among several trade associations would severely impact the benefits of standards to REA.

The following strengths and weaknesses of trade associations have been identified:

Strengths	Weaknesses
- Reduced borrower reliance on REA	- Lack of ability to control standards
- Encourages development of standards-setting expertise in the private sector	- No cost savings for REA
- Wider range of viewpoints	- Funding problems
	- Problems with listing and delisting manufacturers
	- Potential conflicts of interests
	- Lack of timeliness of setting standards
	- Uncertain motivation for developing cost saving standards

Strengths:

Reduced borrower reliance on REA: See Lender section comments.

Encourages development of standards-setting expertise in the private sector: See Lender section comments.

Wider range of viewpoints: See Lender section comments.

Weaknesses:

Lack of ability to control standards by REA: See Lender section comments.

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No cost savings for REA: See Lender section comments.

Funding problems: Most trade associations would encounter funding problems for their standard setting activities. We were told by various parties that the cost of setting standards would be more for a private sector organization than is the cost for REA. This is because of the increased number of people who would likely be involved and the increased time spent on the activity. No matter what the cost, funding could be difficult. All REA borrowers are not members of a trade association. A trade association's members very likely would be unhappy about supporting a function that all REA borrowers were not supporting financially.

Problems with listing and delisting manufacturers: See Lender section comments. In addition, each of the borrowers' trade associations contacted by the project team indicated that they would not list materials.

Potential conflicts of interest: There are numerous concerns about possible conflicts of interest. One such problem is that powerful members could exert undue influence during the standards-setting process to the detriment of other members. Another problem is that some members might be displeased with the standards developed and leave the association. This could undermine the viability of the association.

Lack of timeliness of setting standards: In an organization where standards are set by consensus, negative views must be satisfactorily resolved. This process can take a considerable length of time. Several groups noted that it takes an average of 2 years to develop a standard, but it can take 4 to 6 years. At times, the process even breaks down entirely. In a consensus group there are likely to be many viewpoints expressed. Furthermore, while some committee members are involved in order to get a standard set, some are involved in order to see that a standard is not set. With REA setting the standards, these problems are lessened and the entire process moves much smoother. While REA attempts to resolve all negative opinions, the process can continue without complete resolution.

Uncertain motivation for developing cost saving standards: There is a question as to whether a private sector organization would be motivated to create certain design standards that emphasize quality but reduce costs. REA has an interest in minimizing loan funds and, for loan security reasons, in reducing operating expenses of borrowers. The borrowers share this latter concern. Therefore, the borrowers' trade associations probably would have the necessary motivation to set cost saving standards, but any other trade association may have minimal motivation.

Standards Organizations (Private)

There are several non-government standards developers which set standards applicable to rural electric and telephone systems. However, rural applications are not their primary concern. Representative of these standards organizations are the American Society for Testing and Materials (ASTM), Electronic Industries Association (EIA), and the Institute of Electrical and Electronic Engineers (IEEE). A discussion of the scope and activities of these standards-setting organizations follows.

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ASTM is the largest non-government standards developing organization. ASTM's only function is the development of standards; it is not a trade or professional association. It provides a management system for the development of voluntary, full consensus standards for materials, products, systems, and services. ASTM has developed approximately 7,218 active standards related primarily to the characteristics and performance of various materials, products, and processes, such as iron and steel products, galvanizing processes, paints and petroleum products.

ASTM provides a legal and administrative forum, through a working committee structure, within which manufacturers, users, ultimate consumers and representatives of the general public (such as representatives of government and academia) can meet on a common ground to develop standards to meet the needs of all concerned. ASTM presently has 30,000 members, 16,000 of whom are actively working on 140 main committees and 1,926 subcommittees. ASTM's standards are developed voluntarily by consensus and used voluntarily. Their use becomes mandatory only when government action makes it so.

As mentioned earlier, ASTM provides a "management system" for the development of standards. They have a staff of 200 managers and coordinators; they have no technical engineers or scientists on staff. Therefore, ASTM provides no technical expertise but relies on the committee members to set priorities and to provide expertise, leadership, and testing facilities. Eighty-five percent of its funding comes from the sale of its publications on standards. The remainder comes from dues paid by committee members. It is a non-profit organization.

The project team contacted ASTM representatives who indicated that ASTM would be interested in learning more about REA's standards-setting activities. ASTM representatives commented, that even though their organization had been primarily involved in materials and processes in the past, ASTM is now entering into broader areas of actual application, such as shipbuilding and emergency medical services. ASTM representatives indicated that their committee structure would accommodate any standards-setting function or application.

EIA is a national trade association comprised of companies involved in the manufacturing of electronic components, equipment, and systems. EIA has approximately 3,000 member representatives who participate on 200 main committees and 550 subcommittees and task groups. EIA has developed approximately 480 standards. They are located in Washington, D.C., and have an engineering standards staff of 17 employees. The EIA standards are developed on a consensus basis and use of its standards is voluntary.

IEEE is a national professional society of 225,000 engineers and scientists in engineering, electronics, and related fields. IEEE has 30,000 members who are actively involved in standards development. Standards work is carried out by technical committees of the 37 societies and councils of the institute. IEEE has developed 500 standards and has 800 standards projects underway. IEEE's primary activities to date have been in standardization of units, definitions, methods of measurement and test procedures.

The following strengths and weaknesses for private standards-setting organizations have been identified:

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Strengths

- Reduced borrower reliance on REA
- Encourages development of standards-setting expertise in the private sector
- Wider range of viewpoints

Weaknesses

- Lack of ability to control standards by REA
- No cost savings for REA
- Funding problems
- Problems with listing and delisting manufacturers
- Potential conflicts of interest
- Lack of timeliness of setting standards
- Uncertain motivation for developing cost saving standards

Strengths:

Reduced borrower reliance on REA: See Lender section comments.

Encourages development of standards-setting expertise in the private sector: See Lender section comments.

Wider range of viewpoints: See Lender section comments.

Weaknesses:

Lack of ability to control standards by REA: See Lender section comments. Additionally, ASTM stated that, where the government is involved in one of its standards-setting committees, there must be participation by government representatives, but those representatives are not allowed to control the activities, even though one of them usually chairs the committee.

No cost savings for REA: See Lender section comments.

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Funding problems: Most groups would encounter funding problems for their standards-setting activities. We were told by various parties that the cost of setting standards would be more for a private sector organization than is the cost for REA. This is because of the increased number of people who would likely be involved and the increased time spent on the activity. No matter what the cost, funding could be difficult. Existing standards-setters generally have those serving on committees bear their own expenses. Most of the working time spent on standards, however, occurs between committee meetings. This usually translates as time taken away from the individual's other job duties, and thus is an expense borne by their employer. Therefore, only those companies that can afford to have an engineer who spends considerable time working on standards would have a representative on a committee. To have a representative on each committee becomes much more expensive.

Problems with listing and delisting manufacturers: See Lender section comments.

Potential conflicts of interest: There are numerous concerns about possible conflicts of interest and conflicts with an organization's other objectives. ASTM would not experience a conflict with its objective which is to set standards. This may not be true for other organizations. IEEE, for instance, is a professional association, and setting standards is only one of its concerns. EIA also has many concerns other than standards. Furthermore, a manufacturers group, such as EIA, may be subject to conflicts of interest between manufacturers.

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Lack of timeliness of setting standards: See Lender section comments. Standards-setting committees are comprised of volunteers. They must recognize a need for a particular standard before undertaking the creation of it. Since the committee is composed of volunteers, REA would have to guide and encourage the continuance of the committee's activities.

Uncertain motivation for developing cost saving standards: A standards-setting organization would have minimal motivation to set cost-saving standards.

Contracted Organizations (Private)

The project team has included as contracted organizations such entities as Bellcore, Bell Northern Research, and investor owned utilities (IOU's). The first two would only be related to telecommunications. IOU's, however, can be either telephone or electric. In any case, a contracted organization would be one already involved in setting standards for its own use or for a related company. The one item that is common to all of these groups is that they are interested primarily in urban applications, not rural applications. They could enter into a contract with REA or another organization to set standards for rural applications. If the contract was with a private sector organization, we expect the contracted organization would have basically the same strengths and weaknesses as the organization paying for its services. If the contract was with REA, the strengths and weaknesses of the contracted organization setting standards would be similar to those identified for REA. It is unlikely that REA would realize any cost savings from contracting out the standards-setting functions. Furthermore, REA would have to monitor the

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standards set by the contracted organization to assure that the standards meet REA's objectives.

New Organizations (Private)

One alternative for providing engineering standards-setting functions is an entirely new organization. Such an organization could take many forms in terms of funding, structure, purpose, scope, and authority. A separate study would have to be conducted to determine how such an organization could be established, what form it would take, the expertise needed, the length of time required to set up the organization, and the estimated transitional period needed to become an operating organization. However, to be the most viable private sector alternative, it would have to have significantly fewer weaknesses than the other private sector alternatives set forth in this report.

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Engineering Standards-Setting -- Public Sector or Private Sector

Recommendation

We have already concluded that engineering standards provide many significant benefits directly to REA. There were a signficant number of benefits to other groups which ultimately flow back to REA because they facilitate accomplishment of REA's program objectives. The real issue to be considered in deciding what organization should be responsible for setting standards is what medium will enable REA to function the most effectively and efficiently in meeting its goals and objectives as set forth in REA Bulletin 2-1:301-1.

Based upon our evaluation of the strengths and weaknesses of each alternative considered, the project team recommends that the engineering standards-setting functions be retained in REA at this time.

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Other Items for Further Consideration

Staff effectiveness and efficiency: A review and evaluation as to the effectiveness and efficiency of ESD and TESD in carrying out their program responsibilities was not within the scope of our study; however, views were expressed to us that indicate such a study may be appropriate. With respect to the standards-setting functions, we were told that:

- REA has not stayed current in the issuance of standards for new equipment to enable its inclusion on the List of Acceptable Materials. Two examples given were time-of-use meters and large size distribution conductor.
- The Lists of Acceptable Materials include types of materials that may no longer need to be listed.
- Bulletins are not current, and bulletins that are no longer needed have not been cancelled.
- Standard construction contracts need to be reviewed and revised as necessary to reflect current needs and conditions.
- The cost of preparing close-out documents for low cost projects can be excessive compared to the benefits derived from close-out documents.

Even though we stressed that the scope of our study covered the standards-setting functions only, the following concerns relating to the divisions were expressed:

- Certain functions of the divisions no longer need to be performed. Review of headquarters plans and specifications was one activity mentioned several times as being unnecessary.
- There is some duplication of functions by line and staff divisions.

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Long-range planning: As indicated in the scope of our study, the project team did not in any way consider the President's recommendation to Congress that REA be "phased out" by 1990, as we believed that to be beyond the scope of our assignment. The project team believes, however, that it would be unrealistic to assume that REA will be in business ad infinitum or that REA's lender role will not change from majority to minority lender over time.

When the point in time is reached that REA is making no additional loans and all loan funds have been advanced, there will still be loans outstanding for over thirty years. REA, or whoever is responsible for collection of the outstanding debt, will continue to have a vital interest in loan security. Adequate and dependable service at reasonable rates is the foundation of loan security. The project team believes engineering standards will be needed for many, many years in the rural electric and telecommunications programs.

The project team, therefore, suggests that the Administrator use his considerable influence to establish, at the time the Administrator deems it appropriate, a panel consisting of representatives from organizations which have significant interest in engineering standards applicable to the rural electric and telecommunications programs. The mission of the panel would be to develop a plan of action that would facilitate the transfer of the engineering standards-setting functions from REA to a qualified organization or organizations after it has been determined that it is no longer appropriate for REA to perform these functions.

Users' Fees: Many of the borrower organizations interviewed were asked whether their organizations would be willing to pay users' fees. They

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indicated that if the engineering standards function were retained in REA, they would be willing to pay reasonable fees. However, many expressed reservations as to whether such fees could be equitably applied.

The following issues have been identified by the project team in connection with users' fees:

- According to the USDA Office of General Counsel, the imposition of users' fees in connection with REA's telephone and electric programs would require legislative action by Congress.
- If legislation was enacted to allow users' fees, there would be problems identifying the large and diverse numbers of beneficiaries of REA's standards program.
- There would be significant problems involved in implementing a users' fee program.

APPENDIX 3.—COMMENTS SUBMITTED ON PROPOSED RULEMAKING OF THE RURAL ELECTRIFICATION ADMINISTRATION IN THE MATTER OF GENERAL FUNDS (TELEPHONE PROGRAM) (7 CFR PART 1746)

A. COMMENTS OF THE NATIONAL REA TELEPHONE ASSOCIATION

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*Executive Committee

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COMMENTS

OF THE

NATIONAL REA TELEPHONE ASSOCIATION

CONCERNING THE

PROPOSED RULEMAKING

OF THE

RURAL ELECTRIFICATION ADMINISTRATION, U.S.D.A.

IN THE MATTER OF

GENERAL FUNDS (TELEPHONE PROGRAM)

(7 CFR Part 1746)

SUMMARY OF VIEWS

While the Association endorses and commends REA's stated objective of seeking to provide telephone borrowers more flexibility in the utilization of their revenue, the Association believes that the general funds policy (even as revised) does not accomplish this result, and additionally, should not be adopted as a rule for the following reasons:

- The general funds policy was predicated on an erroneous premise and should be rescinded rather than formalized as a rule;
- The general funds policy is arbitrary, not in accord with generally accepted accounting principles and constitutes an unnecessary burden upon borrowers since it discourages borrowers from accumulating cash reserves or making investments without first obtaining REA approval;
- The general funds policy is inconsistent with deregulation and competition in the telephone industry;

- The proposed rule seeks to impose an additional, non-statutory loan condition which is without basis in the RE Act and therefore, is beyond the power of the agency to adopt.

An Erroneous Premise

Prior to adoption of the policy as a rule, the 1962 policy's origins should be re-examined to determine whether the objectives remain valid. We believe that such a review leads to the conclusion that the underlying policy objectives are no longer valid, if indeed they ever were. The policy was initiated in response to allegations that borrowers were using 2% loan funds to purchase government bonds yielding a higher rate of interest. The following language was included in the House report on the 1962 Agriculture Appropriation bill to deal with this presumed problem:

> "In connection with new loans, the REA should determine a proper level of reserve for each applicant, should set up proper criteria for granting new loans, and should make certain that funds are used for the purposes for which they are made available." (House Report 448, 87th Congress, 1st Session)

Thus, REA Bulletin 300-5, dated February 12, 1962, was born. It has survived in various forms over the years despite its rather checkered history. What began as a recommendation and guide has inevitably become a requirement. What began at a 20% level has shrunk to an 8% level. The policy which sought an "appropriate" level of working capital and reserve funds has become a hard and fast maximum. What began as a policy now becomes a rule. It has been used as a device to conserve loan funds and provide a supplement to Congressionally authorized funding levels for the REA telephone program. In even its most positive light, the policy is an unnecessary and unwarranted intrusion upon a borrower's management flexibility to operate its business. A policy designed to "protect the security interests of the government" is both appropriate and desirable, but such a policy from a lender's perspective necessarily would impose a minimum general funds level not a maximum. Presumably, lenders welcome increased levels of reserve funds and collateral assets if, as the 1969 policy bulletin indicated, they are sincerely interested in each borrower having "sufficient working capital and reserve funds to meet promptly its operating costs, taxes, quarterly debt service payments, routine construction and replacement costs, and for contingencies." Also, as pointed out by REA, appropriate levels of working capital properly vary from company to company making a uniform percentage unworkable. As Administrator Clapp explained, "it is impossible to set a specific amount of general funds that would be appropriate for each and every borrower."

Regarding the concern expressed by the Congressional Committee in 1962, their fears could have been easily allayed by REA without the necessity of the formulation of a new policy. Adequate protections already existed against misuse of loan funds: REA reviews and approves each loan application which clearly sets forth the purposes for which the funds are sought and can only be used; generally, the loan is in connection with a specific construction project and funds are advanced over a period of time as construction progresses; in every case, the loan must be for an Act purpose; a separate bank account is required to avoid commingling of loan funds with the borrower's funds; requisitions must be processed and approved by REA to draw down loan funds; the flow of loan funds is monitored by REA throughout the duration of the project.

Of course, the greatest protection against misuse of loan funds is that it would constitute a criminal act. The concern that low interest rate loan funds might be invested by borrowers at a higher rate in the absence of a general funds policy is simply unrealistic. Moreover, the only appropriate general funds requirement designed to "protect the security interests of the government" should be a minimum funds level rather than a maximum.

The 8% Level is Arbitrary and Burdensome

The current funds level, adopted in 1969, states as follows:

> "Appropriate Level: Each borrower should have sufficient working capital and reserve funds to meet promptly its operating costs, taxes, quarterly debt service payments, routine construction and replacement costs, and for contingencies. Usually, the general funds needed by telephone borrowers for these purposes should not exceed eight percent of total telephone plant, or $100,000, whichever is greater."

The proposed rule translated that policy as follows:

> "(b) As a condition to further advances of loan funds or approval of a loan, borrowers whose general funds exceed the greater of $100,000 or eight percent of Total Telephone Plant (the 'appropriate general funds level') shall be required to use this excess to supplement loan funds for approved loan purposes, except as otherwise authorized by the Administrator of REA." (emphasis supplied)

It goes on to define "general funds" as follows:

"(a) 'General Funds' means all cash and investments not held in trustee or similar accounts as required by loan contract or security instruments, and normally includes the balances of the following accounts from the Federal Communications Commission (FCC) Uniform System of Accounts (USoA) (47 CFR Parts 31 and 33).

Account Title	USoA Class A & B Account No.	Shown on REA form 479 line
Investments in affiliated companies	101.1	A-10
Advances to affiliated companies	1101.2	
Other investments	102	
Miscellaneous physical property	103	A-11
Sinking Funds	104	
Cash - General funds	113.1	
Cash - transfer of funds	113.3	
Working funds - petty cash	115.1	A-12
Working funds - change fund	115.2	
Temporary cash investments	116	
Special cash deposit	114	A-14"

The level of funds which began at 20% has systematically been reduced over the years to the current level of 8%. No justification is provided in the proposed rule for the current level nor is any methodology provided as to its' determination. What may be acceptable as a guide or recommended level becomes intolerable as a strict requirement which must be adherred to as a pre-requisite for loan approvals or advances and uniformly enforced as a rule. No relief is afforded by the elaborate exclusion approval process provided in the proposed rule.

The proposed rule is arbitrary in that contrary to generally accepted accounting principles the calculation of available general funds include both cash and non-cash accounts (e.g. miscellaneous physical property). Also, how can investments in non-cash accounts be used to supplement loan funds?

The proposed rule is arbitrary in that only certain "approved" investments (set forth in the proposed rule) may be excluded by REA from the general funds calculations rather than excluding any investment which enhances loan security.

The proposed rule is unnecessarily burdensome on REA telephone borrowers in that under the guise of establishing an appropriate general funds level the rule in fact serves merely as a device for controlling the borrowers day-to-day business operations by the government. It constrains a borrower's ability to maximize its company revenues well beyond the legitimate concerns of a lender or the requirements of the RE Act. Borrowers will have little management flexibility in the utilization of their own internally generated funds, unrelated to loan security, if the rule is adopted. If the proposal involved disposition of loan funds, restraints such as those proposed would be reasonable and understandable but they do not.

Inconsistent with Telephone Industry Deregulation Policies

The policy and proposed rule is at odds with telephone industry deregulation policies and competition now taking place. With the transition of the telephone industry from a regulated monopoly to competition, REA borrowers should be freed from excessive regulation of their internal policies and business practices. In keeping with the RE Act, REA should confine its rules and policies to those which relate directly to the "expenditure of the moneys loaned and security therefor". (7 U.S.C. 904) This is particularly true in this new era, an era facing all telephone companies, large and small, in which each company must maintain the utmost flexibility in its outlook and business practices if it is to survive. Regulatory fetters must be removed to permit a maximum freedom of participation in this new environment. REA, as well as business, must re-examine its attitudes and policies. Old concepts must give way to new ideas. Old practices must be revised, retaining only those rules and regulations deemed essential and only those which apply directly to loan security or the expenditure of loan funds as the Act requires and as the General Accounting Office (B-169930) and the courts (Sioux Valley Empire Electric Association, Inc. v. Butz, 367 F. Supp. 686 (1973) and 504 F.2nd 168 (1974)) have held. Borrowers must be free to compete if benefits are ever to be derived in this new competitive environment.

A New Loan Condition -- A New Act Purpose -- A New Source of Supplemental Financing

If the proposed rule is adopted, a new condition for a loan or loan advance will be administratively imposed. As quoted above, new subsection (b) of Sec. 1746.20 pre-conditions the approval of a new loan or loan advance upon borrower funds (in excess of the "appropriate general funds level") being utilized to supplement loan funds for approved loan purposes.

In other words, borrowers will be required to utilize their own funds toward approved loan purposes, in lieu of and "to supplement" Congressionally approved loan funds, to the extent that their general funds exceed "the appropriate general funds level" promulgated under the rule. This is wholly inconsistent with the RE Act (which requires the full use by the Administrator of available funds) and the loan program levels set annually by the Congress in the Agriculture Appropriations Acts. Consistent with the authorities previously cited, approval of loans of qualified applicants by the Administrator is a non-discretionary function.

The RE Act sets forth the conditions for loan approval and those conditions are exclusive. They may be altered only by a subsequent Act of Congress. There is no support in the legislative history of the RE Act or its amendments for the proposition that Congress intended Congressionally established loan levels to be supplemented by borrowers in this fashion. To the contrary, Section 307 of the RE Act provides the Administration with direction concerning other financing as follows:

> "When it appears to be Administrator that the loan applicant is able to obtain a loan for part of his credit needs from a responsible cooperative or other credit source at reasonable rates and terms consistent with the loan applicant's ability to pay and the achievement of the Act's objectives, he may request the loan applicant to apply for and accept such a loan concurrently with an insured loan, subject, however, to full use being made by the Administrator of the funds made available hereunder for such insured loans under this title."

On the other hand, the Act is replete with Congressional intention to strengthen the financial standing of borrowers to permit them to enter the private market for supplemental funds. This can only be accomplished through policies designed to enhance a borrower's ability to maximize the use of internally generated revenues. When Congress enacted legislation creating the Rural Telephone Bank, it made the following policy statement concerning supplemental financing:

> "... it is hereby declared to be the policy of the Congress that the growing capital needs of the rural telephone systems require the establishment of a rural telephone bank which will furnish assured and viable sources of supplementary financing ..." (P.L. 92-13)

When Congress amended the RE Act in 1973 to create the revolving fund, it added:

> "... such rural ... telephone systems should be encouraged and assisted to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organization and other sources at reasonable rates and terms consistent with the loan applicant's ability to pay and achievement of the Act's objectives." (P.L. 93-32)

To now require borrowers to utilize their own funds to supplement loan funds in the manner proposed by the rule is inconsistent with and undermines these policies. Borrower equities are already extremely low in relation to other enterprises. By requiring that REA debt capital be supplemented by borrower equity capital only further depletes a borrower's cash reserves and undermines corporate liquidity and financial standing. Since REA does not provide borrowers with all of their funding requirements, they should adopt policies which assist borrowers in developing their resources and ability to achieve the financial strength needed to seek supplemental credit, as Congress directed.

Conclusion

In this age of deregulation and competition borrowers historical revenue sources may be jeopardized and eroded. Policies adopted by the FCC will reduce revenues from toll and terminal equipment. Borrowers will be forced to diversify their operations to meet this challenge. New opportunities will present themselves. Borrowers must have flexibility if they are to adapt to this new environment and face the future with optimism. They also must be free from unwarranted regulatory policies if they are to continue to successfully accomplish their objective of serving rural America with quality, affordable telecommunications services in this new environment. REA must accept this challenge, too. In addition to rescinding the general funds policy, REA should review all other policies with a view toward eliminating those which are restrictive and inefficient. An example are the lien accomodation and subordination policies which continue to hinder REA borrowers abilities to obtain funding from supplemental sources.

For all of the reasons stated, we believe that the proposed rule is beyond the scope of permissable regulatory parameters established by the RE Act and is therefore beyond the power of the agency to adopt. It should also be rescinded as a policy.

B. COMMENTS OF THE NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

In the Matter of

7 CFR Part 1746)
General Funds (Telephone Program))
Rural Electrification Administration)
Proposed Rule)

COMMENTS OF THE NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

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Comments Of The National Telephone Cooperative Association

The National Telephone Cooperative Association (NTCA) submits the following comments in response to the notice of proposed rulemaking published in the Federal Register of June 23, 1983, at pp. 2899929001. The Notice states that the Rural Electrification Administration (REA) proposes to add a new Part 1746 to Chapter XVII in Title 7 of the Code of Federal Regulations (CFR), setting forth the general funds policy of the REA telephone program and revising an existing general funds policy.

A. Purpose of Proposed Rule

1. In explanation of the need for the proposed regulations REA admits that, as a result of its present restrictive general funds policy, "borrowers are effectively barred from using their own general funds to provide needed services, such as CATV, to rural areas". It also states that "This proposal would allow borrowers who could pay dividends or make other distributions without prior REA approval under their mortgage to invest in telecommunication projects".

2. Under the proposed regulations, "REA would then exclude from general funds, for purposes of computing the appropriate general funds level, investments in telecommunications projects up to the amount of allowable dividends or other distributions". Telecommunications services not classified as "telephone service" under the Rural Electrification Act are to be provided by a separate company, "unless otherwise approved by REA".

B. Many Classes of Borrowers Are Not Helped By The Proposed Rule

3. REA is to be commended for publicly recognizing that, as a result of its policy, "borrowers are effectively barred from using their own general funds to provide needed services". The proposed regulations, however, would still effectively bar many REA borrowers from using their own general funds to provide needed services. Such borrowers include:

a. Borrowers that cannot pay any dividends or make other distributions without prior REA approval.

b. Borrowers that can make some distributions without prior approval but not in an amount large enough to provide a subsidiary or other affiliate an equity base which would attract capital from other lenders without a guarantee from the borrower or from REA.

c. Borrowers, particularly cooperatives, that may have restrictions in their state laws, articles of incorporation, or state commission regulations prohibiting or limiting the amount which may be invested in other corporations.

d. Cooperatives that may experience adverse tax effects if they finance these operations through a subsidiary instead of providing the services directly to their members.

e. Cooperatives that might be able to qualify for financing from the Banks for Cooperatives or the National Consumer Cooperative Bank if they could provide a satisfactory lien accommodation but would have difficulty obtaining financing for a subsidiary.

f. Borrowers that could obtain financing from other lenders to provide various types of services if REA would share its mortgage security with other lenders, as authorized by the present Rural Electrification Act, without requiring "compensating benefits" which may render the transaction infeasible.

4. The notice states that "The primary objective of the proposal is to enable borrowers to use their own general funds to enter into new rural telecommunications markets and provide services not included in the term 'telephone service' in Section 203(a) of the Rural Electrification Act (7 U.S.C. 924) (Act). This proposed revision would enable borrowers to provide needed services in rural areas, develop added financial strength through diversification and enhance REA loan security". As indicated above, the proposal is too restrictive as it does not permit many classes of borrowers to

achieve the stated objectives which REA admits would benefit both borrowers and the Federal Government.

5. All borrowers should be encouraged to use their own general funds for such worthwhile objectives, irrespective of their ability to, without prior approval under their mortgages, pay dividends or make other distributions in amounts large enough to provide a subsidiary with the equity needed to attract debt capital.

6. A borrower unable to meet the criteria for dividend and capital credit distributions without prior approval should not be denied the opportunity to diversify its operations in order to ensure its survival in a competitive environment. If a borrower makes a small investment of general funds in a subsidiary or other affiliate, it should be authorized, upon its request, as permitted by the present standard REA mortgage forms, to "extend its credit" to the affiliate. Such extensions of credit could be either directly or by the guarantee of loans made by another lender to the affiliate if the affiliate has insufficient equity of its own to attract the required financing. If borrowers elect to make such an investment without establishing a separate affiliated company, REA should facilitate the securing of the financing required "to satisfy their credit needs" from other lenders by providing lien accommodations or subordinations satisfactory to the other lenders to meet the objectives of Sec. 1 of Public Law 93-32, May 11, 1973.

7. The amount of a borrower's equity is not decreased by investments in either its own facilities or in the stock or debt of an affiliated company. This is true whether or not the amount of such investment exceeds the amount of dividends or other distributions allowable without prior REA approval. Loan security is enhanced to the extent that the diversified operation is more productive than the assets exchanged or liquidated to make the new investment. Loan security is also enhanced if the new investment allows the borrower to successfully maintain its market share in a competitive arena.

C. REA's Unique Definition of General Funds Is Unreasonable

8. The term "General Funds" is defined in the present edition of REA Bulletin 300-5, issued on August 19, 1969, as follows:

> "General Funds" as used in this bulletin includes all the cash and investments which are not held in trustee or similar accounts specified by contractual agreements. (See Exhibit A.)

9. Exhibit A lists "Accounts Used in Computing Ratio of General Funds to Total Telephone Plant". Only seven of the eleven accounts used to determine amounts of "general funds" include the word "cash" or "fund" in their titles. The four which have neither "cash" nor "fund" in their titles but are nevertheless classified as "general

funds" are:

100:1	Investments in affiliated companies
100:2	Advances to affiliated companies
102	Other investments
103	Miscellaneous physical property

10. The proposed regulations include the same four non-cash accounts in the proposed definition of "General Funds", despite the fact that the Federal Communications Commission has proposed to expand the items to be included in Account 103, "Miscellaneous physical property" in one docket and to eliminate it completely in another docket, replacing it with a new and more inclusive account, "Nonregulated investments".

11. In its notice of proposed rulemaking in Docket No. 82-681, issued October 1, 1982, the FCC proposed that telephone companies who lease detariffed PBXs or key systems "record the original cost of the equipment in account 103, 'Miscellaneous physical property'", with related revenues and expenses recorded in account 315, "Income from miscellaneous physical property" and account 174, "Other deferred credits".

12. In its notice of proposed rulemaking in Docket 81-893, released on June 21, 1983, however, the FCC proposed eliminating the "Miscellaneous physical property account" completely and replacing it with a new account, "Nonregulated investments", which would include all the physical property now in Account 103 and all detariffed customer premises equipment and equipment used for enhanced services, as well as other items never included in the present "Miscellaneous physical property" account. The new "Nonregulated investments" account would be a control account for separate books of account covering all equipment and services not regulated by the Federal Communications Commission.

13. The "Miscellaneous physical property" account never contained any cash or funds and should be excluded from any rational definition of "general funds". With the proposed FCC accounting changes, this account or its replacement will contain large amounts of telephone equipment and facilities providing services which the FCC has decided it will no longer require telephone companies to provide under tariff. In any case, whether telephone or other equipment, the balance in this account is not and never will be available to supplement loan funds without requiring the forced liquidation of assets or discontinuance of present services to the detriment of the telephone system and the people it serves.

D. General Fund Limitations Are Inconsistent With Contract Provisions

14. Despite REA's contrary implication in the notice, present contracts and mortgages do not require prior REA approval before borrowers "use their own general funds to construct facilities needed to enter into new rural telecommunications markets and provide

services not included in the term 'telephone service' in Section 203(a) of the Rural Electrification Act..." However, if borrowers do use their general funds in this manner, under both the present and proposed REA policy, they may be penalized at some future date because of REA's unique and incomprehensible definition of "general funds".

15. The term "general funds" does not appear in the standard REA loan contracts and mortgages. It was in loan contracts at one time, but the Administrator's memorandum transmitting the 1969 revision of REA Bulletin 300-5 on "General Funds" stated specifically that "Provisions relating to general funds levels ... will no longer be placed in loan contracts." Therefore, the only legally binding agreement between the borrower and REA does not condition advancement of the funds covered by the contract on the reduction of any specific general funds level or upon any particular use of those funds. Application of such a requirement is clearly outside of, and in violation of, the unambiguous terms of the loan contract. Furthermore, the Administrator lacks the authority to impose such a requirement in future contracts (See, paragraphs 20-22, infra). Thus, to the extent REA denies otherwise qualified borrowers drawdowns of previously authorized loan funds simply because of the level or use of their general funds, it is violating the terms of the loan contract and is potentially liable for the breach.

E. REA's Restrictions On Loans And Advances Rest On A Questionable Legal Basis

16. Considering physical property and the other three non-current asset accounts (100:1, 100:2 and 102) as general funds can have the effect of unreasonably denying many rural telephone systems financing authorized by the Rural Electrification Act.

17. The proposed Part 1746 states that "It is REA policy that general funds in excess of the appropriate level shall be applied to uses which conserve REA loans funds." (Sec. 1746.1) It further provides that borrowers whose general funds exceed the "appropriate general funds level" shall be required to use this excess to supplement loan funds for approved loan purposes. (Sec. 1746.20) This requirement for supplemental financing is being made without regard to (a) a Comptroller General's decision (Opinion No. B-169930, September 28, 1970) which is supported by relevant case law, (b) provisions in loan contracts covering advances of loan funds, and (c) the limitations added to the Rural Electrification Act in 1973 by Secs. 305 and 307, as interpreted by the courts.

18. The present general funds policy was developed before both the Comptroller General's decision of 1970 and the 1973 amendments to the Rural Electrification Act. These amendments were enacted to free REA borrowers from a number of provisions of the Consolidated Farm and Rural Development Act (RDA) under which REA borrowers were compelled to obtain financing in the first four months of 1973. These RDA provisions included (a) a determination that credit was not available elsewhere and (b) "graduation" to other financing

(requiring repayment of the Government debt before it was due) if the Government determined that credit was available elsewhere at some time in the future.

19. The 1973 amendments, therefore, added new sections 305 and 307 to the Act to require the Administrator to make full use of available insured loans as a prerequisite to requiring supplemental financing. The District Court in Sioux Valley Empire Electric Association Inc. v. Butz, 367 F. Supp 686 (D.S.D. 1973), aff'd 504 F.2d 168 (8th Cir. 1974) pointed out that the Congress, in enacting the 1973 amendments, had confronted the prospects of Presidential impoundment and "condemned the Administrator's actions in forging that policy by expressly commanding that he not do so in the future". The Court of Appeals in the same Sioux Valley case pointed out that "The amendment of 1973 represents a political settlement of the difference between the Administration and the Congress over the operation and direction of the Rural Electrification Program and thus would control the terms and conditions of any loan applications made after its effective date." As that case makes clear, the administrator is not free to unilaterally terminate a federal program or spend less than the full amount of appropriations made. Sioux Valley, supra, at 175-8. Yet denial of loan funds or loan advances simply because of a borrower's level of general funds is tantamount to either an effort to impound authorized loan funds (maximum authorized levels have not been met in many years) or an effort to terminate the loan program by forcing borrowers to choose between vital low interest loans and the diversification necessary for them to survive in the deregulated environment. Denying advances under approved loans on the basis that the borrower has excess "general funds" which REA considers as "available" to meet a contractor's bills, although actually expended in the past for miscellaneous physical plant or stocks or bonds of an affiliate, is not only unreasonable but also a potential violation of sections 305 and 307 as it can compel the borrower to obtain the funds denied by REA from other lenders without coordination with the section 307 prerequisite.

20. The Comptroller General, as long ago as September 28, 1970, in Opinion No. B-169930, informed the Secretary of Agriculture that the Rural Electrification Act restricts the terms and conditions of REA loans to those "relating to the expenditure of the moneys loaned and the security therefor". (Underscoring added by the Comptroller General). The District Court in Sioux Valley, supra, at 694, also took note of this limitation and stated that "the Secretary has the nondiscretionary duty to make the loans to qualified applicants". REA stopped including provisions relating to general funds levels in loan contracts one year before the Comptroller General's decision. As a result of the ruling, however, REA decided not to include in loan contracts a proposed requirement that electric borrowers invest in a supplementary lending institution as a condition of receiving an REA loan. In a similar manner, REA should conform its bulletin on general funds policies to the Comptroller's decision and remove a borrower's general funds level from consideration when a loan or loan

advance is applied for. As the court in *City of Los Angeles* v. *Coleman*, 397 F. Supp. 547 (D.D.C. 1975) clearly stated, although an

> ...administrative agency has been interpreting the Congressional mandate in a certain restrictive manner for a number of years, such an interpretation is not controlling. The Court must determine for itself the intent of Congress by an independent examination of the pertinent legislative history and the language of the statutes themselves. *Id.*, at 554.

21. Significantly, the above cited conclusion in the Comptroller General's decision is supported by the relevant case law. Indeed, the court in the *Sioux Valley* case, *supra*, noted that program funding could not be denied for reasons "unrelated to achieving the goals of the Act". Similar conclusions regarding the executive branch's inability to refuse to apportion Congressionally authorized funds for other than "program-related" reasons were reached by Courts in the District of Columbia. *See*, for e.g., *City of Los Angeles* v. *Coleman*, 397 F. Supp. 547 (D.D.C. 1975); *Pennsylvania* v. *Weinberger*, 367 F. Supp. 1378 (D.D.C. 1973), *Guadamuz* v. *Ash*, 368 F. Supp. 1233 (D.D.C. 1973); *Local 2677, American Federation of Government Employees* v. *Phillips*, 358 F. Supp. 60 (D.D.C. 1973).

22. These cases make it clear that executive agencies are not free to deny funds to eligible borrowers when the result of such denial is to "subvert" the primary purpose of the Act's funding mechanism. REA's restrictions on the level of general funds and its *ex post facto* restrictions on the use of general funds are not related to the expenditure of REA loan funds and are not necessary to enhance loan security. Quite the contrary, prudent use of general funds for non-Act purposes can strengthen the loan security by making the borrower more competitive. In addition, denial of loan funds or loan advances to companies seeking to extend or upgrade service to rural areas is tantamount to subversion of the purpose of the RE Act. Two types of borrowers are particularly affected by this failure to comport with both the case law and the Comptroller General's Opinion:

a. *Borrowers that have complied with all conditions precedent to the advance of funds under the loan contract executed by the Administrator*. This contract not only requires the Government to advance funds for approved loan purposes when such conditions have been met, but also stipulates that the "Administrator and the Borrower may from time to time *determine by agreement* the amount required to enable the Borrower to perform its obligations" under the contract (Emphasis supplied) as a prerequisite for any reduction in the maximum amount of the loan.

b. *Potential borrowers that may already have physical assets (e.g. cable television plant or detariffed customer premises equipment) among their assets in an amount which causes the loan applicant's "general funds" (under REA's unique definition) to exceed 8 percent of its total telephone plant*. Denying a new loan applicant financing or requiring the applicant to dispose of its cable facilities because REA has determined the applicant has "general funds in excess of the proper level" in such a case would be without a rational basis in fact or law.

23. Moreover, eliminating the present restrictive policy on general funds would not create an improper additional demand for REA loan funds for purposes authorized under the Rural Electrification Act. As the lower court in the Sioux Valley case made clear, while the executive branch is responsible for effecting savings in administering Congressional programs, such savings must not be accomplished at the expense of the program. The court stated that:

> Congress has conferred a great deal of power upon the President to enable him to confront the problems of on increasingly complex economy. But, in this Court's view, Congress has not yet gone so far, at least with respect to the legislation with which we presently deal, to confer upon the President the power to reassess and reorder Congressional priorities in an attempt to effect Executive economic policies. 367 F. Supp. 686, 697 (1973).

F. REA's Regulation Of General Funds Is Unnecessary and Duplicates State Regulation

24. Neither the present bulletin nor the proposed regulation meet the Comptroller General's criteria of permissible loan conditions -- those "relating to the expenditure of the moneys loaned and the security therefor". In fact the Federal Register notice states, "This proposed revision would enable borrowers to provide needed services in rural areas, develop added financial strength through diversification, and enhance loan security." Only borrowers which meet the proposed conditions, however, could enhance loan security in this way. Rescinding the present bulletin and canceling the proposed regulation would therefore enable many more borrowers to achieve these results which benefit both the borrowers and REA.

25. The Draft Regulatory Impact Analysis prepared by REA considered only four options. It did not include the beneficial option of rescinding a policy which effectively bars borrowers "from using their own general funds to provide needed services" without replacing it with new regulations which would have the same result for many borrowers. Such artificial narrowing of options is not consistent with standards applicable to agency rulemaking. Pillai v. Civil Aeronautics Board, 485 F.2d 1018 (1973).

26. Sec. 202 of the Rural Electrification Act provides that "Nothing contained in this Act shall be construed to deprive any State commission , board, or other agency of jurisdiction under any State law, now or hereafter effective, to regulate telephone service which is not subject to regulation by the Federal Communications Commission under the Communications Act of 1934, including the rates for such service."

27. Regulatory commissions in all states review the propriety of a utility's investments in determing the proper rate base, including allowances for working capital. REA controls on "general funds" thus duplicate, to a considerable extent, a function which is already being performed at the state level by regulatory commissions and at the federal level by the Internal Revenue Service which polices unreasonable accumulations of funds.

28. The proposed Part 1746 continues, and in fact increases, the unnecessary regulation of small business enterprises. Terminal equipment has never been considered "general funds" by REA in the past. Nevertheless, the proposed Part 1746 would classify it as the equivalent of cash and require the borrower to establish that "it is a type and has a value reasonably related to the telephone service provided by the borrower" before REA will admit that such equipment is not available to pay the next bill from the construction contractor.

29. Regulations of this nature are extremely difficult to justify in this age of regulatory reform enthusiasm, when Presidents (irrespective of party affiliation) direct agencies to eliminate unnecessary and duplicative regulations. REA should therefore cancel all general fund level limitations and all restrictions on investments of non-loan funds which are not related to loan security.

G. The Proposal Does Not Include The Lien Accommodations Needed For Diversified Operations And Enhanced Loan Security

30. The REA proposal did not address the related problem on lien accommodations. In a resolution adopted by its members at the 1983 annual meeting, NTCA was directed to "give priority attention to obtaining changes in REA's policies on general funds and lien accommodations in order to facilitate the diversification of borrowers' operations in a competitive environment and the obtaining of funds from various sources for both Act and non-Act purposes; and if necessary, seek remedial action through the legislative and judicial processes...." (Emphasis added)

31. As set forth in the "options" paper prepared by NTCA in July 1982, most rural telephone systems financed through the REA-administered programs have difficulty in obtaining other financing "at reasonable rates and terms" because:

a. Their interest coverage ratio is too low.

b. Their equity is too small to meet the credit standards of most lenders.

c. Their individual needs are not large enough to attract other lenders or absorb banking, accounting, and attorney fees, printing and engraving, and other bond issue costs.

d. REA has a first lien on all of their property "now owned or hereafter acquired".

32. REA should therefore recognize that a vital key to obtaining financing from other sources "at reasonable rates and terms" is REA's willingness to share its mortgage security on the borrower's existing system with other lenders. There would be no National Rural Utilities Cooperative Finance Corporation (CFC) today without the standard form of REA-CFC common mortgage for distribution systems developed in 1973. Even CFC, however, has difficulties in obtaining and providing financing for REA borrowers when the proposed financing is not permitted to be secured by the "type 1 lien accommodation" of this mortgage form.

33. Lien accommodations which secure the notes of the new lender "equally and ratably" with the existing secured notes should be made readily available to encourage and assist rural telephone systems "to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources at reasonable rates and terms consistent with the loan applicant's ability to pay and achievement of the Act's objectives". Sec. 1 of Public Law 93-32, May 11, 1973.

34. Instead of issuing unnecessary regulations restricting the efforts of rural telephone systems to diversify their operations and enhance their revenues and loan security, REA should provide the lien accommodations and subordinations needed to obtain necessary financing which REA is not providing. It should broaden its concepts of "Act purposes" and "compensating benefits" to recognize that encouraging and assisting borrowers to satisfy some of their credit needs from other sources and improving the efficiency, effectiveness or financial stability of their systems can reasonably qualify as both "Act purposes" and "compensating benefits".

H. Summary

35. REA is to be commended for publicly recognizing that, as a result of its existing general funds policy, "borrowers are effectively barred from using their own general funds to provide needed services". Unfortunately, the proposed addition of a new Part 1746 to Title 7 of the Code of Federal Regulations would still effectively bar many REA borrowers from using their *own* general funds to provide *needed* services.

36. The amount of a borrower's equity and REA's loan security is not decreased by investments in its own facilities or in stock or debt of an affiliated company and should not be disapproved *ex post facto* by REA.

37. The existing and proposed definitions of "general funds" are unique, encompassing money expended in prior years which is no longer available as a substitute for loan funds.

38. There is no basis in fact or law for REA to deny loans and loan advances on the basis that some forms of telecommunication

property and other non-current assets are available as a substitute for loan funds.

39. The present and proposed general funds policies conflict with borrowers' rights under loan contracts executed by REA.

40. The present and proposed general funds policies also conflict with decisions of the Comptroller General and the Courts which hold that the Rural Electrification Act restricts the terms and conditions of REA loans to those "relating to the expenditure of the moneys loaned and the security therefor".

41. In addition, these policies conflict with the 1973 Rural Electrification Act amendments by having the effect of requiring supplemental financing without taking into consideration the prerequisites of the newly added Sections 305 and 307.

42. The present and proposed general funds policies constitute unnecessary duplicative regulation of small business enterprises. Such regulation should be eliminated as it prevents small telephone systems from achieving the purported purpose of the new Part 1746, i.e., "...[to] enable borrowers to provide needed services in rural areas, develop added financial strength through diversification, and enhance loan security".

43. The REA proposal does not address the related problem of lien accommodations.

44. REA should cancel all general funds level limitations and all restrictions on investments which are not related to loan security. It should provide the lien accommodations and subordinations rural telephone systems require to satisfy the credit needs not being met by REA financing programs.

Respectfully submitted,

NATIONAL TELEPHONE COOPERATIVE
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Dated: August 23, 1983

APPENDIX 4.—REA BULLETIN CONCERNING TEMPORARY INVESTMENT OF LOAN FUNDS

:File With REA :
:Bulletin 26-1:327-1:

UNITED STATES DEPARTMENT OF AGRICULTURE
Rural Electrification Administration

October 31, 1979

SUBJECT: Timely Submission of Requisitions and Temporary Investment of Funds Received Pursuant to REA Loan Guarantees, or from the Rural Telephone Bank, or Rural Electrification and Telephone Revolving Fund

TO: Borrowers with Loans from REA or RTB or Loan Guarantees from REA

I. Purpose: To emphasize the requirement that requisitions for loan funds are not to be submitted prematurely, or for amounts greater than immediate needs; and to provide guidelines for the temporary investment of funds advanced by the Federal Financing Bank (FFB) and other lenders pursuant to REA loan guarantees or from the Rural Telephone Bank (RTB) or the Rural Electrification and Telephone Revolving Fund (RETRF), and on the proper use of idle funds.

II. Timely Submission of Requisitions:

A. Loan fund advances should be timed to assure they occur only when essential to meet current needs for funds for disbursement. Requesting advances before they are needed to make payments on contracts and other obligations is to be avoided.

B. Requisitions for advances of funds are processed on a timely basis as received. The requisitions for RETRF and RTB advances should not be submitted to REA more than 30 days before the funds are to be disbursed in payment of obligations. For requisitions under loan guarantees, the requested date for receipt of the advances should coincide as nearly as possible with the date upon which disbursements are to be made. In reviewing and approving requisitions, the Area Office will inform the Borrower that advances will be withheld if it appears that funds are being requested too far in advance of the time needed.

C. Loan funds which have been requisitioned and advanced should be retained in the Borrower's "Trustee, Special Construction Account" (Electric) or "Trustee, REA Construction Fund Account" (Telephone) until properly supported for reimbursing general funds or for direct payment of approved construction costs. If the funds have been advanced to reimburse the Borrower's general funds for previously approved and completed construction, the amount should be transferred promptly to general funds, with proper support.

III. Idle FFB and RTB Funds:

A. When unanticipated events cause a delay in using advances from FFB and RTB loans (but not from RETRF loans), Borrowers may, without obtaining prior approval from REA, (1) invest the idle funds in short-term securities issued by the United States Treasury (these may be purchased under repurchase agreements -- agreements by banks and securities dealers to repurchase U. S. securities sold by them at a fixed price), or (2) deposit the idle funds, if permitted by state law to do so, in savings accounts of banks and other institutions insured by agencies of the Federal Government. Borrowers may also invest idle funds in other short-term securities, including certificates of deposit, with the prior approval of REA.

B. Each security or other investment purchased or made pursuant to this authorization, together with all other related documentation, shall identify the Borrower by the corporate name of the Borrower followed by the words "Trustee, Rural Telephone Bank (Rural Electrification Administration, in the case of an FFB loan) Special Construction Loan Funds". All temporary investments of FFB and RTB funds and all income thereon will be considered as part of the trustee account and subject to the same controls as cash in that account.

C. Securities and other investments should have maturity dates or other liquidating provisions that assure the availability of funds as required for the completion of projects and the payment of obligations. Generally, the yield rate of the temporary investment will be lower than the interest rate charged on the loan advances. Even when the rate of yield on the investment is higher, the amount of investment income will generally be less than interest costs because the holding period of the temporary investment will be less than the period between the date of the advance and the date the funds are expended for construction.

D. Any instrument evidencing a security or other investment herein authorized to be purchased or made may not be sold, discounted or pledged as collateral for a loan or as security for the performance of an obligation, or for any other purpose, without the express written consent in advance of the Administrator.

E. The Administrator may, in his sole discretion, require a Borrower to pledge any security or other evidence of investment authorized hereby by forwarding to him all pertinent instruments and related documentation as the Administrator may reasonably require. The Administrator reserves the right to suspend the authorization herein.

F. Borrowers are responsible for effective safekeeping of redeemable and negotiable securities and other investments.

G. All interest receipts on these investments shall be deposited in the appropriate account described in II.C above and the Construction Work in Progress Account shall be credited for the full amount of such deposits. Appropriate adjustment shall also be incorporated into the Construction Fund Budget to reflect the additional funds available for construction purposes.

H. On the next requisition submitted to REA, the proceeds shall be accounted for as follows:

1. Electric Borrowers shall account for the proceeds on the Financial Requirement and Expenditure Statement (REA Form 595) in order that REA can make necessary adjustments on the Primary Budget Purpose Sheet in the manner described in Bulletin 26-1, Section III.D.2. Proceeds from the Sale of Property -- Sales of $25,000 and more.

   In addition, the proceeds shall be reported under the same Primary Budget Purpose(s) as the advance of funds from which the investment was originally derived; whether or not the advance was invested in whole or in part.

2. Telephone Borrowers shall account for the proceeds on the Financial Requirements Statement (REA Form 481) in order that REA can make the necessary adjustments on the budgetary records, as provided for in REA Bulletin 327-1, Appendix A, Section 11. Other Funds (Credit).

IV Idle Funds of Other Guaranteed Lenders: Funds advanced by a guaranteed lender other than FFB may, if so permitted by such lender, be invested under the terms and conditions prescribed for FFB advances in III, above.

Idle RETRF Funds: When unanticipated events cause delay in using advances from RETRF, the Borrower may (1) return the idle funds to REA as a "refund of an advance" and later request the funds when needed; or (2) invest the 2 percent funds in 2 Percent Treasury Bonds R.E.A. Series, and 5 percent funds in 5 Percent Treasury Certificates of Indebtedness - R.E.A. Series. (See REA Bulletin 103-9:403-4 for complete details.) All interest received on these investments shall be deposited in the Construction Fund/Trustee Account and the Construction Work in Progress Account shall be credited for the full amount of the deposit. Appropriate adjustment shall also be incorporated into the Construction Fund Budget to reflect the additional funds available for construction purposes. For reporting requirements see III.H. above

Robert W. Feragen
ROBERT W FERAGEN
Administrator